UNIVERSITY OF LJUBLJANA
FACULTY OF ECONOMICS

MASTER'S THESIS

CURRENT FINANCIAL CRISIS AND ITS CONSEQUENCES FOR THE ECONOMY OF KOSOVO – A COMPARATIVE ANALYSIS OF SOUTH EAST EUROPEAN COUNTRIES

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TABLE OF CONTENTS

LIST OF FIGURES

LIST OF TABLES

INTRODUCTION

The financial crises are like hurricanes. They happen regularly, bringing hazard and usually you can trace back the causes, while hardly can predict the consequences. It is so, because economic crises, very easy can provoke social and political crises or even result in changing the world economic and political order.

Vince Cable (2009, p. 28) believes that the greatest and most destructive in our memory is the Great Crash of 1929-1932, which caused mass unemployment and a fall of one third in USA Gross Domestic Product (hereinafter: GDP). The financial crash of the 1929 triggered the world economy into depression, with unpredictable consequences, therefore it “cooked the soup” for raising colonialist aspirations among superpowers at that time, which afterwards resulted in Second World War. Whereas in terms of the economic consequences, the Great Depression of 1929 required decades to recover the world economy to the levels of the starting point of the 1929.

This is not so, for other financial crises that has happen over the time. Crises like the loan and saving crises that happen in the USA at 1980's, or the bursting bubble in dot com shares in USA and Europe, and financial crises in Asia – Thailand, South Korea, Malaysia and Taiwan, followed by a default on Russian debt, had different contagious magnitude. These crises have inflicted considerable damage in the countries concerned, whereas there was not recorded any significant impact on the rest of the world politics or economy.

The current global financial crisis, which started on the USA, has its origin on the fundaments of the Anglo-Saxon financial system, while the triggering cause for downfall of this pyramidal financial system, lays on the subprime loan portfolio. As the economy started to recover from the last downturn of 2000 - 2001 on the expense of low interest rates, this encouraged mortgage market, and therefore created perfect conditions for everyone to buy a house and live the American Dream. Easy credit driven by securitization: no cash and no capital needed, was another factor that enabled banks to follow very aggressive lending strategy.

Crises never occur just because of the single factor. Analyzing crises, separately, proves that they come because of numerous combined factors. However, at the heart of each financial crisis, that hit all sorts of countries - fast growing and slower growing countries, were the massive inflows of capital in the national economy, and the institutional vulnerability of the countries which were missing the adequate financial regulation and prudent macroeconomic management, in order to downscale properly capital inflows in the real economy.

Downscale of the capital, as a term, defines the orientation of capital on the national level. This has to do mainly with method, lending technology and practices of the domestic banks and other governmental and non-governmental institutions, used to direct capital on the national level, after the capital from international markets reached the country.

With financial openness, the domestic economic system becomes considerably more prone to shocks from international financial markets. This is particularly so in cases where international financial transactions are large in relation to the size of the domestic economy.

As capital pours in, usually in volumes that are very large for domestic financial markets to absorb, the domestic currency must appreciate sharply in real terms to accommodate the inflows and the current account deficit balloons. The larger and more sustained the capital inflows, the sharper the currency appreciation and the current account deficit (Agosin, M. & Huaita, F. 2010). Whereas, on the national level, because of excess liquidity created in the market, due to relaxed international liquidity constrains, domestic banks become less cautious lenders. Therefore, through expanding their lending programs, they either boost domestic consumption, which additionally contributes on the current account deficit, or inflate prices of non-tradable segments of the economy (real estate, stocks in the market).

Perhaps this is the reason why after 1980, when deregulation of financial markets took place, the financial booms that always ended up in the crisis, were more frequent and pro cyclical than never before. During this period, starting from the beginning of 1980's until nowadays, around 20 financial distresses with various regional impact magnitudes were registered.

The capital inflow boom coming from developed economies, as a modern financial phenomenon, was recent experience also for the economies of the Central, East and South East Europe (hereinafter: CESEE), after year 1990. Developed economies of the Western Europe were the origin of the capital that flew toward CESEE, during this period. Whereas the trigger of this particular capital mobility is closely linked with two important occurrences, at this period of time;

- New circumstances created on the financial markets of the Western Europe, because of banking market saturation. Hence traditional commercial banks, driven by profit maximization had to look for new opportunities, and,

- Fundamental changes caused because of economic and political reforms that happened in the CESEE countries. These changes correspond to fall of the communism and planned economy, as an economic and political system that was dominant in these countries since the end of the World War II.

As a result of these changes in the political landscape of CESEE countries and their integration to the international financial markets, the financial sector of these countries were subject to massive capital inflows, much larger than their economies and institutions on place were able to absorb.

The capital came from traditional banks in form of portfolio investment or Foreign Direct Investments (either acquiring existing state owned banks, or starting new banks from the scratch). Eager to expand the business out of the borders of western world, these banks developed fast credit growth strategy, which later created much vulnerability in the economic and financial sector of these countries. For that reason, when the last financial crisis hit these economies, their financial and economic sectors were very weak and fragile. This consequently resulted on slowing down their economic growth, while having negative effects on the financial sector of these countries.

Kosovo, as a country that belongs to the group of South East European (hereinafter: SEE) countries, has had much more favorable position in this regards. Unlike other developing countries of SEE, there were no substantial capital inflow booms (which we call for short, **capital surges**) in the Kosovo's financial sector. Therefore, the capital account crisis or **sudden stop** effect as they have been called in the recent academic literature is not observable in Kosovo (Agosin, M., & Huaita, F., 2010).

The reason for these distinct characteristics, in regards to capital surges in the country, perhaps lays on low opportunities that Kosovo's economy presented in the view of foreign investors. Due to its size and overall political situation, Kosovo did not present huge possibility for profitable investments; therefore, no capital surges on the recent period are noticed in the country.

In addition, Kosovo's banking regulators applied a cautious policy when it came to increase number of banks in the market. The actual policy gave two positive effects. Besides, enabling Central Bank of Kosovo, as a supervisory authority, to control closely lending operations of commercial banks in Kosovo, it has also created a relaxed competitive environment among banks; hence, none of the banks had reason to develop aggressive lending strategy, thus engage on financing risky investments. Because of these distinct characteristics, the effects of financial crisis did not spill over in the economy of Kosovo, as it was evident in some SEE countries.

In other words, this presents the main hypothesis of this study. Since there were no substantial capital surges in the Kosovo's financial system, and since the Kosovo prudential authorities made a fine job, on the period before the last financial crisis hit the region, the sudden stop effect in Kosovo is not observable. Hence the financial crisis did not have such a profound effect like in other SEE countries, although some signs of endogenous developments are observables, as the empirical study has shown in case of construction sector. In addition to that, Kosovo's regulatory authorities have applied prudent supervision policy, needed to control the actually size of capital inflows in the country and afterwards controlling properly the downscaling of this capital from the commercial banks into the real sector of the economy.

Through making a comparative analysis of main macroeconomic and financial indicators among six countries of SEE, hereinafter SEE6 (Albania, Bosnia and Herzegovina, Kosovo, Macedonia, Montenegro and Serbia), we will testify the main hypothesis of the study; those effects were different among countries, whereas Kosovo due to it's distinctive characteristics has been least influenced by the last global financial turmoil.

The thesis is organized in the following way. The first section discusses in general the impact of the capital inflow booms for transition and emerging economies. Especially in cases when mass capital inflows are larger in relation to the size of the domestic economy and recipient countries are missing prudent macroeconomic and financial policy in order to manage properly these capital inflows in the national level. The experience of CESEE countries during the 90’s, after these countries liberalized their capital account and transformed their economic and political system toward free market orientation, is subject of analysis at this part of the study.

The subject of the second section will be the comparative analysis of macroeconomic and financial sector (banking sector is considered as a subgroup within the financial sector) indicators of SEE 6 countries, in order to argument the main hypothesis of the study. Since Kosovo will be on the center of this comparative analysis, the section will start by describing the overall situation of economic and financial sector in the country.

Consequently, several sub hypotheses will appear on this section, which will be adjusted to the reality of the group of SEE 6 countries. Since these sub hypotheses will be in line with main hypothesis of the study adjusted accordingly to the reality of SEE 6 countries, the comparative analysis will be in function of testing the validity of these sub hypothesis, hence contributing to the main assumption of the study.

On the third section of the study, the empirical research, from the microeconomic perspective will take place. The research in this part of the study, will try to prove the main conclusions brought on the previous section, showing that Kosovo due to its distinct characteristics mainly related to the non-existence of the capital inflow booms in the pre crisis period, has remained stable and avoided effects of the last financial crisis. The balance sheet analysis of the small and medium enterprises will take place on this section.

The ProCredit Bank database is used as a source of information for these data it. In order to see the possible effects of the financial crisis in the economy of Kosovo, the evaluation of balance sheet of more than 200 small and medium enterprises is conducted for the period of time 2007 - 2011. Different ratios are used, in order to measure the development of important balance sheet items of these enterprises. Ratios such as debt equity ratio, indebtedness index, turnover to total assets and profitability to total assets are taken as indicators in order to measure any possible down turn in the business environment in Kosovo during this period.

On the last section, we will summarize the findings from our comparative and empirical research, and come with a conclusion about the validity of the main hypothesis.

1 STRUCTURAL CAUSES OF THE MODERN TIME FINANCIAL CRISIS

The era of financial market integration and light government regulations is known to have started, mainly, since the late 70's. The resumption of globalization, rise of capital movement, liberalization of capital accounts and accelerated deregulations accompanied with rapid financial innovations were the characteristics that followed the period of free market.

The liberalization of the national capital accounts created vast opportunities for the world economy and especially for the countries that were lagging behind the western countries in terms of the economic development. These new changes made it easier to channel funds from countries, which had surplus of capital, towards countries that had investment ideas but were missing capital in order to implement these ideas. For the first time after the World War II, the world economy was functioning on the principles of the national economy. The capital was flowing without limits, mainly having as a regular pattern, the direction from developed economies toward dynamic markets of emerging economies.

Only during the 1990's because of capital market liberalization and low interest rates in developed economies, mainly in Japan and Europe in order to fight the mild recession, the investors went abroad in search for higher yields. According to the Institute for International Finance, regarding data on capital flows; in 1990's the private capital flow to emerging markets was 42.2 billion USD. This amount increased in 1995 to 231 billion USD.

The foreign investors from developed economies, during the 1990 s, saw dynamic markets of East Asian, Latin American and CESEE countries as a terrain for vast investment opportunities. All these countries, at this period, were experiencing shift on their political and economic systems. The new political forces, created lately, enabled these countries to open their borders and turned the protectionism as a dominant economic policy for many years, into free market orientation policy.

Nevertheless, the liberalization of the capital accounts created a double edge sword effect. Besides having contributed positively on the economic development of emerging economies, it has also created much vulnerability on the existing economic and financial system of these countries.

Capital inflow, historically, have had impact on the financial environment, not as much in-developed world, as in the transitional and emerging economies. Perhaps transition and emerging economies are more vulnerable due to their economic and political deficiencies inherited from the past. The inflationary problems, slow economic growth, weak currency, political instability, unsound and corrupted institutions are chronic diseases of emerging countries. Therefore, the first wave of market liberalization has found these countries unprepared to challenge the effects of the opened economy. On the other hand, these countries in order to rebuild confidence on their currency, have adapted fixed exchange rate regime, pegged to the hard currency.

This monetary policy has shown to be very dangerous for all countries that have structural problems on their balance of payments, which very often is a case for emerging and transitional economies. It is so, because capital surges on emerging economies make pressure on national currency. Huge capital inflow into the country makes local currency appreciated compared to other currencies. This vicious cycle worsens the situation of the deficit on the balance of payment. Strong currency increases the purchasing power of consumers, hence increases the imports. While at the same time decreases the competitiveness of exports in the international market**.**

Because of the above-mentioned shocks, the fixed exchange rate regimes are under pressure and extremely difficult to be managed. In order to maintain fixity of the value of local currency, in relation to strong currency, the central bank has to intervene constantly in the market by using foreign exchange reserves. These measures will stabilize the supply and demand of the local currency in the market, hence stabilizing the natural appreciation. This is fine, as long as foreign capital continues to flow in the economy and keep feeding country's foreign exchange reserves.

However, we recall what has been said before in the case of emerging and transition countries! They are economically weak and politically instable. Therefore, just a small oscillation on their economic or political life is a negative signal for foreign investors and turn capital surges into capital stop.

Agosin and Huaita (2010, p. 664) on their paper dedicated to capital flows to emerging economies argue that capital surges are the ultimate cause of capital account crisis, or sudden stops as they have been called on the last academic literature. They focus their study on the fact that capital flows to emerging economies are very large relative to relevant macroeconomic variable and very volatile. Therefore, at some point of time they become more destabilizing since the capital flows, due to its size relative to domestic financial sector are scaled into broad money supply.

Conclusions of these two author's about the vulnerability of the emerging economies, in times when these countries integrate to international financial markets, gain on argument particularly ,when position of developed countries in relation to the global capital mobility is taken into account. They prove that developed countries, particularly the large ones, due to the size of their economies and financial markets adjust more easily to changes in the direction and size of capital flows, since the size of the capital flows are smaller relative to their economy.

Alike the previous authors, Krugman and Miskin (1999) at their models, which are used to explain the East Asian and Latin American financial crisis at the 90's, mentions the liberalization of financial accounts and surge of capital from developed countries to the emerging economies of these two continents as a main reason, but not only, that contributed to this crisis!

They also find numerous endogenous factors, which in combination with huge capital inflows contributed to the malfunction of the internal system, which later resulted on the destabilization of the entire financial system. They attribute endogenous factors to the imprudent macroeconomic policy and existence of the moral hazard between lenders and borrowers, which later develops into adverse selection problems. Therefore financial liberalization must be managed extremely carefully because of it s side effects which have been explained above.

The information asymmetry that exists between businesses and banks and poor supervision regulations of banks, is another issue. Since these economies are highly informal, banks many times banks face difficulties to intermediate and direct funds towards good investment opportunities. Whereas, banks having excess liquidity and under pressure of high competition, find ways to avoid regulations of supervision authorities, which anyway are weak, thus end up financing bad and risky investment ideas. This is very risky and affects negatively the quality of the bank’s assets.

The typical exemplification of what has been said so far regarding pressure that capital flow makes for developing economies, is the situation of former communist countries of CESEE after the year 1990. Since this occurrence presents a very substantial argument for the study, on more detail on the following section will be elaborated, the overall situation, during that period time.

1.1 Financialization in the European Union area and liberalization of CESEE on 90's

Countries of Central East and Southeastern Europe experienced fast credit growth rates in the private sector prior to the financial and economic crisis of 2007-2010. This lending boom has the origin in the 1990's and it is associated with the expansion of foreign banks, mainly from European Union (hereinafter: EU) countries, in the region. The changes are closely linked to the two fundamental reasons that happened at this period in EU and CESEE countries.

First reason has to do with structural changes in the EU countries, which from Predrag Cetkovic on his study about the role of the foreign banks on the financial instability in Balkan Countries, has been summarized under term **financialization** (Cetkovic,2011,p.1).

This term is associated with the maturity level of the financial markets in advanced economies of the EU area. Because of development of the capital markets and new possibilities of big enterprises to borrow directly from the public, the traditional commercial banks have lost the opportunities to expand reasonably in this market.

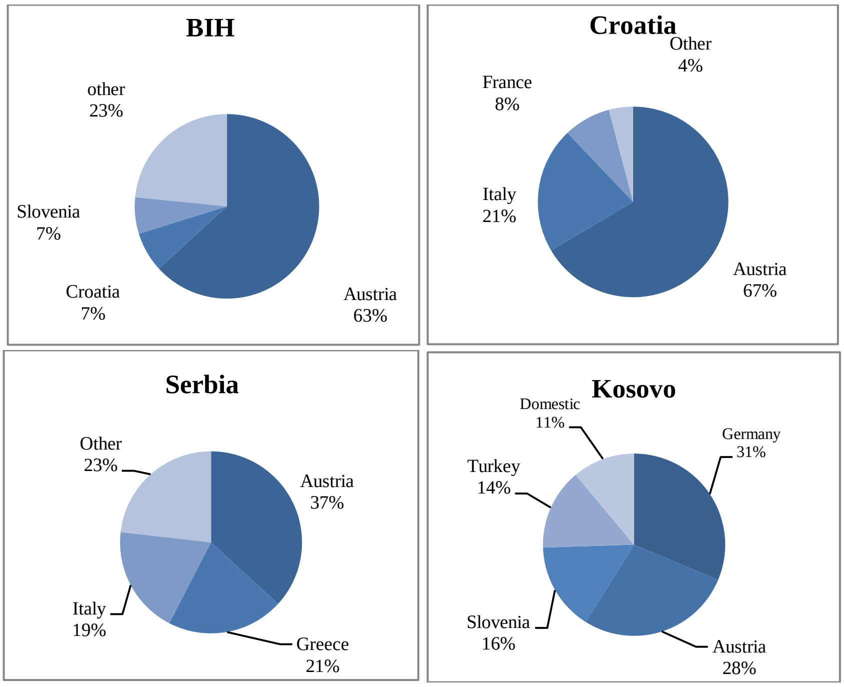
The shrink of interest rates margin and competition from other forms of finance has classified the market of the banking industry in the Western Europe as saturated. The remaining possibilities were to expand lending activities to private households on the existing markets of EU countries, or follow expansion strategy in the transition economies of the CESEE, which from the perspective of the European traditional commercial banks, presented a market with huge growth potential.

This situation in the financial sector in EU coincided with general changes on political and economic system in CESEE that took place on 1990 s, which actually present the second reason that affected changes in the financial environment of CESEE. Privatization and liberalization policies in the CESEE countries that took place after the fall of communism and central planned economy, enabled entry of foreign banks which were looking for new, dynamic and more profitable markets.

Large capital flows into CESEE countries, from developed economies of EU has followed, as number of these banks has expanded their activity in the transition economies of these countries. Moreover, the capital inflow into these countries, in most of the cases, came in form of new investments from the banks located in EU member states, which have chosen to expand their operating activities in the CESEE market. Therefore, these banks, and their aggressive growth strategies boosted the credit growth in these countries.

The main driver behind the credit expansion by foreign banks was profit maximization, accompanied by an increase at their risk appetite (Cetkovic, 2011,p.1). High interest rate margins, which were actually in the private sector of the market of CESEE, attracted many banks from Germany, Austria, Italy, and France and in some countries; Greek and Spanish banks played an important role. As a result, banks from the EU-15 countries are now major players in the SEE region, holding up to 90% of total banking assets in many countries.

Figure 1. Bank's Ownership Structure by Country of Origin, the Case of BIH, Croatia, Serbia and Kosovo



*Note** .The ownership structure for Bosnia and Herzegovina is based on shareholders' capital, for Croatia and Serbia on assets of the banking sector. The ownership structure for Kosovo relates to 31st December 2011, respectively 30th June 2010 for Serbia and was calculated on the basis of individual bank data, which were obtained from the homepage of national banks from each respective country

Source*: Financial Stability Report Central Bank of Bosnia and Herzegovina*, 2010, p. 35, Figure 8*; Financial Stability Report Central National Bank of Croatia*, 2010, p.14, Figure 13*; Financial Stability Report* National *Bank of Serbia*, 2010, p.26, Figure 3, *Financial Stability Report-Central Bank of Kosovo*, 2010, p.23,Figure 7

For illustration purposes the previous chart presents the structure of foreign ownership by country of origin in Bosnia and Herzegovina (hereinafter: BIH), Croatia, Serbia and Kosovo. As the charts shows, the Austrian and Italian capital prevails in three countries in

BIH, Croatia, Serbia, whereas Austrian capital has significant shares also in case of Kosovo.

The credit expansion in CESEE, which has been pushed by the foreign banks, have had positive effects in the short term. It has boosted the domestic demand, and in short run has accelerated economic growth. Nevertheless, the catch was how to build a sustainable growth model that would have give results in the long run, since the actually model of economic growth was based on credit expansion or debt led growth.

The competition among banks grew fiercer as they were running for market share and increase of the profit. Thus, they engaged on financing risky loans, and expanded lending activities on financing consumer need of household sector, based on increase of indebtedness for two sectors: household and private enterprises.

The side effects of this growth model, based on debt growth, were evident mainly in three areas:

- It has deteriorated the country s trade balance,
- It increased indebtedness of the private sector, thus raise the concern about quality of the loan portfolio, and
- Consequently, it made the entire economic and financial system more fragile if it was needed to absorb shocks of possible crisis in the financial system.

Since the big portion of the lending activities went on financing consumer needs of household sector, less has remained for financing investment projects that add value to the national output. Increase of the consumption component results on decrease of the saving or investment component (Gross Domestic Product components), as they, all are integrative parts of the same variable, in this case Gross Domestic Product.

This has short-term effect on accelerating economic growth, which in reality happened in the CESEE countries, but has missed the sound fundamentals for building sustainable growth in the long run. The growth model was based on boosting the domestic demand through increasing indebtedness of the private sector, but not building healthy comparative advantage of the country's economy, which is a good promise for the long-term growth.

As we know from the theory, and practically proved, increase of the consumption in cases when the fulfillment of these consumption needs is based on imports, directly results on increase of the trade balance deficits. Thus the credit expansion on CESEE, indirectly, has financed the country's trade balance deficit, since it has fueled the import through indebting the private sector.

The growth model that we are talking about, based on the debt growth, makes the entire economic and financial system more fragile, in two aspects;

- **First-**increase of leverage among the private enterprises and households, goes on straight correlation with decrease of the loan portfolio quality. This is a natural process, and it is measured with indebtedness index, which shows the participation of total installments on the net income of the company or household unit. Hence, as the ratio increases, ignoring all other accidental external factors, on the same correlation increases the possibility for loan default, as the unit has to dedicate more out of net income for repaying of loan installment.
- **Second -** is that usually in the indebtedness economy, the refinance of the debts is normal and very frequent phenomenon. Thus in times of financial crisis, as the raising concerns, among banks, about loan portfolio quality and liquidity materializes, the banks slowdown the lending activities. Consequently, both, the entire economic development based on leverage growth on the macro level, and the private sector on the micro level are hit by the effects, in this case credit crunch, of the financial crisis. The slowdown of the credit led to the decrease of domestic demand which results on GDP drop. Whereas on the micro level, regarding the private enterprises and households, the credit crunch causes insolvency, thus resulting on immediate deterioration of the bank's assets quality, since banks stop refinancing debts of the private sector.

In reality, this is what happened in the CESEE after the crash of the US subprime crisis, because of the above-mentioned facts. The economic model of these countries was hit from the last financial crisis, whereas the effect differentiated, depending on the country's characteristic. In almost all of the countries, we could see deterioration of macroeconomic indicators, national accounts and hard times for banking sector.

We still are waiting to see the effects of the most recent crisis in euro zone, the sovereign debt crisis of Greece, Italy, Spain and Portugal. The effects, for some Balkan countries that for many years now, have build strong business ties with these countries, are expected to be devastative.

2 ECONOMIC AND FINANCIAL ENVIRONMENTIN SEE6

2.1 Two opinions regarding the impact of the financial crisis in Kosovo

In general, the performance of the economy of Kosovo during the recent period has followed the global economic developments, which has dominated worldwide because of the recent financial instability in the global environment. This is considered to be a normal reaction, taking into consideration its small size, openness and inability to influence the global economic trend.

Nevertheless, the first glance on the major economic indicators gives a different outlook compare with other countries. The positive results in terms of the economic growth, not major deterioration of the national accounts (in any case, systematically, estimated on low level) and generally, the stable performance in the financial sector creates the impression that Kosovo has remained immune and avoided the effects of the last global crisis.

On the other hand, a comparative analysis of development fundaments or qualitative indicators of Kosovo with other countries in the region shed more light on the general situation. We should not forget that Kosovo, as no other country in the region, is in race with time. Wasted years and delays to improve general business environment, political stability, avert corruption and inefficiencies of the local bureaucracy, have much more negative consequences for Kosovo than in any other country in the region, always having in mind that Kosovo, in this regards, presently, stands at much worst position, than any other country in the region.

According to World Bank Regular Report that investigates the regulation that enhances rules and those that constrain it, Kosovo is ranked 113th out of 183 economies all over the world, the position that is much worse than in other comparative countries in the region. Hence, Bulgaria and Albania are ranked in the position of 44, respectively 82.

The effects of the global crisis are as well evident on superficial quantitative indicators.

These are mainly reflected, on;

- Slowing down of the growth trend compare to pre crisis period,
- Missing opportunities for attracting foreign investments (in any case on low level, even on pre crisis period) in the country,
- Inability of the present economic growth to decrease unemployment,
- Worsening of country's trade balance, and
- Decrease of remittances.

Above-mentioned facts are few among many others, which in case of Kosovo have deviated from the desired results.

Based on what has been commented so far, two general opinions dominate when it comes to analyzing the effects of the last financial crisis in the economy of Kosovo.

First opinion supports the belief that Kosovo has mostly remained untouched, or mildly affected by the first wave of the financial crisis.
This opinion prevails, because economy continued to grow through all post crisis years, whereas the financial sector did not show any signs of deteriorations, even though this

sector was the most fragile sector on developed and developing economies during the financial crisis.

Whereas the second opinion believes that main effects of the global financial crisis, should be looked on the lost opportunities that would have enabled the faster growth and increase of competitive capacities of the national economy. Loss of opportunities to attract new capital flow in form of Foreign Direct Investment (hereinafter: FDI), ever since the financial turmoil started in the global level, is the impact that has been reflected in Kosovo. Increased conservatism among foreign investors, especially when it came on investing on the transition economies, from the perspective of Kosovo is rather an external consequence of the crisis than the ability of the local political and economic environment to attract FDI.

The economy of Kosovo is lagging behind other economies in the region. Therefore, in order to catch up with those economies and build competitive capacities, it is needed much more effort and higher growth rate then it s neighboring countries, which for Kosovo represent main trading partners.

Based on above elaboration and regarding the impact of the financial crisis in Kosovo, next part of analysis will try to answer following questions:

- Has Kosovo remained as an isolated island, and immune, in time when the last financial turmoil has affected all countries in the region?

In case this is true, than we need to find out what are the distinctiveness of the Kosovo's economy and its financial system that made possible to keep it's economic and financial system immune from the effects of the financial crisis. In fact, the answer on this question will help us to prove or disapprove the main hypothesis of this study. In case we find that Kosovo remained intact from the effects of the last financial crisis, and the reason for this situation lays on the non existence of capital surges followed by a prudent regulatory policy , than our hypothesis proves to be right.

- Or, missed opportunities to attract capital inflow in form of FDI in the country that would have made possible to catch up and make the economy competitive with other countries in the region, simply has more negative effects than just the effects on temporary deterioration of the national macroeconomic indicators.

In order to answer these two questions, two methods of research will take place;

- **Comparative analysis** of macroeconomic and financial performance of Kosovo in relation to its neighboring SEE 6 countries, for the period of time 2007-2011, will be conducted. The subject of comparison will be main macroeconomic and financial indicators of six countries that are located on the Balkan Region. We believe that these samples of countries are very comparable, and findings of the analysis will be very fruitful for our study as they share a lot of similarities in terms of their economic development, geographic positioning and business relations among themselves,

- **"Balance sheet" model**, as a tool for conducting empirical research, will be used, in order to see the effects of the financial crisis on the microeconomic level.

With this method, we will be analyzing the evolution of the balance sheet of the sample of enterprises, for the period of time 2007-2011. By using this method and analyzing the empirical data on balance sheet of more than 200 enterprises that are included in the sample, we will try to find out the effects or possible effects in future of the financial crisis in the real sector of Kosovo. The analyses will be focused on measuring the level of indebtedness and profitability of the enterprises, which are selected on the sample. Besides looking upon the crisis effects in Kosovo, from this perspective, the data will also reveal the financial situation of enterprises in different economic sectors, hence giving an estimation regarding the existing business environment in the country and possible endogenous problems characteristic for certain economic sectors.

Besides trying to answer the question about possible effects of the financial crisis in Kosovo, both methods of research will also be in the function of researching the possible effects of the crisis in the economies of SEE. Moreover, the research will be in function of proving the validity of the main hypothesis of the study, which considers the capital flow boom which latter causes sudden stop as an ultimate cause for destabilization of financial systems on the national economies.

2.2 Comparative analysis of macroeconomic environment among countries of SEE6, during the period 2007-2011

Even though the world economy, particularly the SEE countries, were experiencing the slowdown in the economic growth during the period of time 2007-2011, on the contrary the economy of Kosovo continues to be one of the economies with the highest growth rate in the region. The average GDP growth rate, during the year 2011, of the SEE6 countries was 3.03%, with an unequal distribution among the countries. Thus, Kosovo having the highest growth rate of 5.0 %, while Serbia and BIH denoting the lowest economic growth of 2.0 %.

SEE6 is referring to Albania, BIH, Kosovo, Macedonia, Montenegro and Serbia - these countries will serve as a subject of comparison with Kosovo, since they belong to the some region (former Yugoslavia)and their economies are relatively similar in terms of size and it s structure.

Same situation repeats even when we compare the growth rate for the period 2007 - 2011, the period, which is used as a reference for estimating the effects of the last financial crisis.

As Table 1 shows, the average growth rate for SEE6 is around 3.4 % for all countries, while Kosovo and Albania are the only countries that have performed better than the group's average.

Table 1. SEE6 GDP Real Growth Rates (%), Period 2007-2011

	2007	2008	2009	2010	2011	Average per country
Albania	6.0	7.7	3.3	3.5	3.0	**4.7**
BIH	6.8	5.7	-3.1	0.8	2.0	**2.4**
Kosovo	6.3	6.9	2.9	4.0	5.3	**5.1**
Macedonia	6.1	5.0	-0.9	1.8	3.0	**3.0**
Montenegro	10.7	6.9	-5.7	2.5	2.9	**3.5**
Serbia	5.4	3.8	-3.5	1.0	2.0	**1.7**
Average of SEE 6 per year	**6.9**	**6.0**	**-1.2**	**2.3**	**3.0**	**3.4**

Source: World Bank Economic Report, *South East Regular Economic Report*, 2011, p. 1, Table 1.

At the first sight, the above mentioned figures gives a kind of relief and concludes that economy of Kosovo performed much better, it has shown higher stability than other countries and did not experience the effects of the last financial crisis. During the entire period, Kosovo did not face a negative growth rate or recession, which is not a case with other countries. The spillover effects of the global financial crisis became evident in the year 2009, when almost all countries in the table has experienced a recession.
The exceptions are Kosovo and Albania!

In both cases even though the crisis effects were evident, none of these countries did not experience recession of economic activity at national level. Nevertheless, the slowdown of economic growth was obvious, since both countries, in 2009 has experienced decline on growth rate, but still with positive results, which was not a case with other countries.
Likewise, in 2010, soon after year 2009 when the growth rate hit the floor, the recuperation period for both countries, started. Thus in 2010, Kosovo has denoted 4.0% economic growth, an abrupt jump of 1.1% compare to one year before, whereas in 2011 the growth rate reached 5.3%. Albania reached 3.5% growth rate, in 2010, respectively 3.0% one year after. Nevertheless, as the table shows, in both cases the economic growth after crisis years (2010-2011) remained inferior to pre crisis period (2007- 2008).

The above-mentioned figures do not give the entire picture about the possible effects of the financial crisis in the economy of Kosovo. This conclusion comes because of following arguments:

- The economy of Kosovo has lower base than other five countries, which are used as a comparison subject. Therefore, the relative growth is not a reliable and valid estimation in this case. The GDP per capita ranks Kosovo on the last place, among all other five countries, which are subject of the comparative analysis.

Following table will present the GDP per capita for Kosovo and other neighboring countries, in order to see the position of Kosovo regarding this indicator.

Table 2. GDP per Capita in € on SEE6, for the Period 2008 - 2010

Country	2008	2009	2010
Albania	2,785.00	2,711.00	2,736.00
BIH	6,500.00	6,500.00	6,600.00
Kosovo	1,785.00	1,786.00	1,886.00
Macedonia	3,278.00	3,253.00	3,374.00
Montenegro	4,898.00	4,770.00	4,876.00
Serbia	10,805.00	10,557.00	10,808.00

Source: World Bank Economic Report, *South East Regular Economic Report*, 2011, p. 5, Table 7.

As figures in the table shows, Kosovo takes the last position in terms of GDP per capita in comparison with other countries. The difference with the second last country, which is Albania, for the year 2010, is as large as 30%, while the difference with best performing country, which is Serbia, in this regard is fivefold. These figures show the inferiority of Kosovo's economy in comparison with other countries in the region.

- So far, Kosovo has missed chances to attract, on satisfactory level, foreign direct investors to invest in the economy of Kosovo. Moreover, most concerning is the fact that these investments are declining on the years following the year 2007 (year 2007 is considered as t = 0, when the financial crisis started to hit the national economies in the world, therefore it is used as a starting point of analysis).

FDI are very important factor for accelerating economic growth in almost all the countries. However, the role of FDI s is of crucial importance for transition and small sized economies, where the financial strength and access to capital, for enterprises, is major problem. This applies also in the case of Kosovo, considering the nature, size, level of development of the economy and financial sector in the country.

The economy of Kosovo is depending very much on private owned small and medium enterprises. These types of enterprises are very important for the national economy, as they generate employment and are main accelerators of the national economic growth. Nevertheless, their contribution is small due to their limited potential. They either miss needed capital to grow big enough in order to penetrate in the foreign markets, or necessary management skills for choosing the right growth strategy. Regarding the capital, their only source, beside family capital, is external finance in form of credit from local banks. Both sources are limited due to the client and bank size. Therefore, they choose the "status quo strategy "in order to remain at the same size and strengthen their position in the existing market.

FDI s have vital role in this environment and their role is not limited only on providing capital in the country and generating employment. FDI's character is important, also on bringing management skills and know- how, which are scarce, especially in the transitional developing economies. Because of the financial problems in the global economy, the level of FDI in Kosovo decreased, though never been at satisfactory level. Table 3 shows that FDI has reduced on the years that followed the financial crisis. In 2008, the ratio of FDI to GDP decreased to 9.5%, a reduction of 3.4% compare to year 2007. The reduction continued on the subsequent years, thus reaching the bottom level of 7.3%, in the year 2010.

The reason of this negative trend is worsening of the economic and financial situation in the countries that represent main source of FDI for Kosovo, after the last financial crisis. One of the most important investor countries are Slovenia and Germany. Especially Slovenia, as one of the most important investor in Kosovo has been hit hardly by the effect of last financial crisis.
Following table shows the actually trend of FDI during the period of time 2007-2011. The reduction of FDI, on absolute terms, is observable on every year, having the most emphatic drop in 2009. In 2010, the trend turned upward, in comparison to one year before, which is a positive sign for the economy. However, the results still did not reach the level of the pre crisis period.

Table 3. FDI in Kosovo for the Period 2007-2010

Year	**FDI (€ millions)**	**Ratio of FDI to GDP (%)**	**Year to year growth (%)**
2007	440.70	12.99	
2008	366.50	9.52	-16.84
2009	291.40	7.45	-20.49
2010	311.20	7.38	6.79

Source: Central Bank of Kosovo, *Annual Report*, 2010, p.23, Table 14.

Kosovo s macroeconomic stability continues to be challenged by four main fundamental problems:

- The consumption component has the highest share in the country's GDP. While the investments component, which is crucial for increasing the nation's potential output and promotes growth in the long run, it is on the low level. On the following table, we will present the composition of GDP according to expenditure method, for SEE6, in order to see the share of two main components on GDP of Kosovo and compare it with other countries.

Table 4. GDP by Expenditure Approach for SEE6 (%)

Country	GDP by Expenditure	2007	2008	2009	2010
Albania	Consumption	90.42	89.46	n/a	n/a
	Capital formation- investments	38.66	38.11	n/a	n/a
BIH	Consumption	101.59	100.69	98.97	99.80
	Capital formation- investments	26.45	28.29	20.93	19.39
Kosovo	Consumption	112.28	112.00	109.00	108.00
	Capital formation- investments	26.30	28.40	29.75	32.47
Macedonia	Consumption	93.80	98.40	95.60	n/a
	Capital formation- investments	19.60	18.20	19.10	n/a
Montenegro	Consumption	108.50	113.85	106.18	105.61
	Capital formation- investments	32.35	38.25	26.76	21.11
Serbia	Consumption	96.90	97.10	99.80	n/a
	Capital formation- investments	24.30	23.80	18.80	n/a

Source: *Annual Report of the Republic of Albania,* 2010, p.3, Table 2; *Annual Report of the BIH,* 2010, p.18, Table 7; *Annual Report of the Republic of Kosovo,* 2010, p.15, Table 6*; Annual Report of Republic of Macedonia,* 2010, p.19, Table13*; Annual Report of Montenegro,* 2010, p.9, Table 2*; Annual Report of Republic of Serbia,* 2010, p.23, Table 12.

As the table shows, the level of consumption and capital formation component in all countries exceeds sum of 100 % of the GDP or national output, for each specific country. The national output has two main components; the national savings/investments and national consumption. These are two main components of the country's total output or GDP. Savings are generated when current consumption is less than current output.

The country either consumes and has short-term effect in the economy or saves and afterwards decides where to invest; in capital formation which increases the potential of the country's economy for the future, or in capital projects - infrastructure that contribute to the nation’s welfare. One of the most important points, needed to know about national accounting, is that national savings (national savings S^T = private savings S^P +government savings SG), under hypothetical assumption, should equalize the national investments (national investments I^T = private investments I^P+ Government Investments $I^{G)}$. If the sum of the total investments made at home exceeds the national savings, then the country is said to be running a current account deficit. Therefore in our example from the table, analyzing

GDP by expenditure for SEE6 approach, the difference above 100% is covered by negative sum of net exports (current account deficit), which is an actuality for all countries in our sample.

The table shows that Kosovo and Montenegro are two countries with highest participation of the consumption component. In both countries, even though with declining tendencies, the value of consumption exceeds the value of GDP. The situation makes sense, up to certain degree, in the case of Montenegro, taking into consideration that they have chosen growth strategy based on the sectors of tourism and other services. However, in the case of Kosovo this disproportion is an important issue that needs to be looked upon it.

The consumption from public and private sectors is an important component that increases the domestic demand, which afterward generates growth. Nevertheless, as it has been elaborated previously, the growth model based on consumption has short-term perspective and does not create sustainable model of the economic growth.

- High unemployment rate - which is not absorbed by the current economic growth rates in the country. This comes due to low base of the economic development in Kosovo. Hence, the actual economic growth rate does not create enough economic opportunities for decreasing unemployment rate. This comes because of the large unemployed rate that presently exist in Kosovo and new labor force that joins labor market every year. Each year, 30'000 young active population joins the labor force in Kosovo. Therefore, for Kosovo to keep the same level of the unemployment rate, it is needed to realize over 7% of the yearly economic growth rate. This having in mind the large bulk of new work force (30'000 people) that each year joins the labor market of Kosovo, which is already much higher than in other SEE countries (the unemployment rate in Kosovo is above 40% of the total active labor force).

- The high current account deficit - which results due to high dependence of domestic consumption on imported goods from abroad. As the table 5 shows, Kosovo is a consumption economy by GDP expenditure approach, which fulfills its consumption needs from import. The continuous growth of imports that have large weight on Kosovo's trade, has caused a continuous increase on the current account deficit and takes away, each year, around 40% of GDP.

Following tables will show the historical data about development current account balance for Kosovo and SEE6 countries.

Table 5 will present the position of the Kosovo's current account and trade balance, in nominal value and as portion to GDP. While the table 6 will show the ratio of current account balance to GDP for SEE 6 countries (including Kosovo), hence will enable us to make a valid comparison among these countries. Analyzing figures in both tables we can see that negative balance in case of Kosovo, is more emphatic than in other countries.

Moreover, the development trend of the current account and trade balance in case of Kosovo is surging, which is not a case with other countries that show declining trends.

Table 5. Current Account and Trade Balance for Kosovo, in Nominal Value and as a Portion to GDP, Period 2007-2010

	Current Account Balance		**Trade Balance**	
Year	Nominal Value in millions	Ratio to GDP (%)	Nominal Value in millions	Ratio to GDP (%)
2007	-354.00	-10.43	-1,309.43	-38.58
2008	-628.00	-16.31	-1,587.12	-41.21
2009	-603.00	-15.41	-1,552.65	-39.69
2010	-684.00	-16.23	-1,710.48	-40.57

Source: Central Bank of Kosovo, *Annual Report of Central Bank of Kosovo*, 2010, p.49, Table 31.

The deterioration of the trade balance is considered a systematic problem for the economy of Kosovo, and it is expected to prevail in the near future. This is because domestic production of Kosovo does not have comparative advantage, which effectively can compete with other countries, and soften the disproportion in the trade balance account as the main contributor to the current account deficit.

Table 6. Current Account Balance for SEE 6 as a Portion to GDP, Period 2007-2011 (%).

Year	**2007**	**2008**	**2009**	**2010**	**2011**
Albania	-10.40	-15.10	-13.50	-11.80	-10.90
BIH	-10.70	-14.30	-6.20	-5.60	-6.20
Kosovo	-10.43	-16.31	-15.41	-16.23	-25.00
Macedonia	-7.00	-12.80	-6.70	-2.80	-5.50
Montenegro	-39.50	-50.60	-30.30	-25.60	-24.50
Serbia	-16.10	-21.60	-7.10	-7.20	-7.70
Average of SEE 6 per year	**-15.69%**	**-21.78%**	**-13.20%**	**-11.54%**	**-13.30**

Source: World Bank Economic Report, *South East Europe Regular Economic Report,* 2011, p. 8, Table 14.

Comparing the tables about the share of consumption component on GDP, and the last table about trade balance, it can be easily concluded the countries that consume more and invest less, have higher deficit rate in relation to GDP. In our case, Kosovo and Montenegro are in higher position compared with group's average.

- The government and other local authorities do not have any clear strategy about the economic development of the country. The absence of the clear path how Kosovo will build its comparative advantage and improve the business environment (fight corruption and inefficiencies of local authorities), are considered to be a fundamental problem for the economic development in the future. So far, almost everything has been based on the local private initiative and the main drivers of the country's economic activity are small and medium local private enterprises.

The government has to have a clear strategy of how will attract the FDIs, which are considered to be a significant factor for accelerating economic activity in the transitional economies. This is a big challenge for Kosovo, since, as it has been said before Kosovo is in the race with time, with itself and with other neighboring countries, which are standing at much more advanced position in this respect.

2.3 Comparative analysis of financial and banking sector on SEE6 during period 2007-2011

2.3.1 Characteristics of financial and banking sector in Kosovo

The financial system in Kosovo is considered as immature and very basic. In many ways, the financial sector of this country, has avoided the first wave of the last global financial crises, even though in all countries around the world, this sector has been considered the main target of the last financial crises. Despite the ongoing financial turmoil in developed and developing countries, Kosovo s financial system mostly remained intact from the crises. All the financial and accounting indicators of the financial institutions in Kosovo remained stabile within the tolerance level, with no significant signs of deterioration.

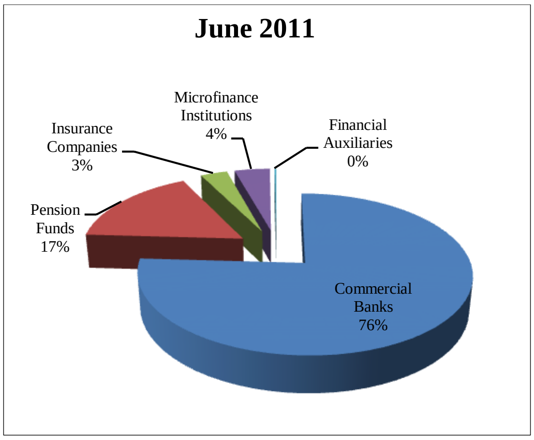
Nevertheless we could have seen slight decline on the performance of the banks in terms of the asset quality performance, slowdown on lending activities and profitability, but still within the manageable levels and far better than the situation that other countries were facing during the same period of time.

What is the distinctiveness of the Kosovo's financial system that made possible to keep away the major effects of the financial crises?
In order to answer this question and make the subject more tangible, we will give a general overview of the financial sector in Kosovo, with significant emphasis on the banking sector. The comparative analysis with other banking sectors from SEE6countries, will be conducted well, in order to compare the performance of this sector and effects of the

financial crisis, in different countries that share a lot in common in terms of size, maturity and history of development.

Banking sector in Kosovo, represents the largest component of Kosovo s financial segment. Commercial banks compose around 75.9% of total financial sector assets. The share of insurance enterprises, pension funds and other financial intermediaries (mainly microfinance institutions)in total assets of financial corporation's, by June 2011, is around 3.1 percent, 16.7 percent, and 4.3 percent respectively. Having this much participation, the trend of the financial assets is completely dependent on the development of the assets in the banking sector.
Graphically compilation of the financial sector in Kosovo by financial corporations would look as shown in the following chart.

Figure 2. Structure of the Financial System in Kosovo, in Terms of Value of Assets



Source: Central Bank of Kosovo, *Financial Stability Report 2011*, 2011, p. 35, Figure 13.

From the regulatory perspective, the banking sector in Kosovo may be considered “liberal’ as no interest rate controls, no directed credit programs from the government, and no capital account controls exist.
The Central Banking of Kosovo, as the regulatory and supervisory authority of the financial sector does not have an emphatic regulatory limit that determines working technology of banks. It encourages banks to keep loans to deposits ratio below 80%, in order to limit rapid credit expansion and risk exposure. However, when it comes to other rules, the banking business is developed based on the working technology of each specific bank.

2.3.2 Ownership structure of banks in SEE 6

The founder capital of banks in Kosovo mostly originates from foreign investors, while the small portion comes from domestic ownership. Following the ownership structure of the banks in Kosovo, in order to facilitate the analysis, banks in Kosovo are classified into two groups. First group is consisted of five, out of eight banks that operate in Kosovo, under full foreign capital. Whereas the second group includes other, two banks with local ownership. On the analysis is not included Komercialna Banka AD Beograd, due to its limited scope of operation in terms of offered services and branch out in the country (it operates only in the north part of Kosovo and provides mainly payment services to Serbian population who are living in this part of Kosovo).

Following table shows, participation of these two groups in terms of value of assets. Foreign owned banks dominate significantly in terms of the value of assets. By end of December 2011, 89% of total banking sector assets, or € 2.1 billion out of € 2.4 billion, belonged to banks under group I (foreign owned banks), while the remaining 11% are managed by banks which are under local ownership. In the group of foreign banks, the German and Austrian capital dominates with 31% respectively 27.6%, followed by Slovenian (15.6%) and Turkish capital (14%).

Table 7. Participation of Foreign/Domestic Capital in Banking Sector of Kosovo, Dec. 2011

Group I	Value of Assets (€ millions)	Group II	Value of Assets (€ millions)
Total PCB Bank	774,538	**Total BE Bank**	152,086
Total RBKO Bank	683,772	**Total BPB Bank**	124,430
Total NLB Bank	386,777		
Total TEB Bank	213,998		
Total BKT Bank	135,574		
TOTAL ASSETS Group I	**2,194,658**	**TOTAL ASSETS Group II**	**276,516**

Source: Central Bank of Kosovo, *Financial Stability Report*, 2011, p. 20, Table 13

In comparison with other countries of SEE, the banking system in Kosovo has highest share of foreign capital. As table below shows (table 8), the average share of foreign ownership in the local banking sector of the respective countries, by year, 2005 is 67% and Kosovo that year stood near the average. Nevertheless, the figure increased in coming years for all countries (except Bulgaria), and regarding Kosovo the increase was higher than the average figure.

By year 2009, the share of foreign capital in banking sector of Kosovo has reached 90%. Albania and Croatia are two other countries where the share of foreign capital to total banking capital exceeds 90 %, thus leading the group in this respect.

Table 8, will present the percentage of foreign ownership of banks in some of CEE countries for the period 2005- 2009.

Table 8. Share of Foreign Capital in the Banking Sector of Some SEE Countries

Country	Number of Banks					Share of foreign capital (in %)				
	2005	2006	2007	2008	2009	2005	2006	2007	2008	2009
Average						**67.07**	**73.49**	**79.47**	**81.59**	**80.56**
Albania	16	17	17	16	16	86.30	85.70	88.80	91.80	92.30
BIH	24	23	22	20	20	70.20	75.50	74.20	83.10	83.30
Bulgaria	34	32	19	30	30	74.90	72.80	72.80	71.70	66.00
Croatia	38	38	38	33	32	81.70	86.60	90.80	90.60	90.10
Kosovo	7	6	8	8	8	66.30	71.20	90.10	91.00	91.50
Macedonia	20	19	18	18	18	50.00	55.00	70.00	75.00	70.00
Moldova	16	15	16	16	15	50.60	62.70	71.90	74.10	77.60
Montenegro	10	10	10	n/a	n/a	68	n/a	n/a	n/a	n/a
Romania	40	39	42	43	42	69	78.80	79.40	77.90	76.50
Serbia	40	37	35	34	34	53.80	73.10	77.20	79.10	77.70

Source: Bank of Albania, *Supervision Annual Report of Albania - Share of Foreign Capital in Some Countries of the Region 2010*, 2010, p. 23, Table 8.

Analysis of the origin of capital in the banking sector is very important because of two aspects:

- First aspect has to do with the level of capital inflows in the country. Referring to what has been said before, high level of capital inflows from abroad is one of the preconditions that might weaken or deteriorate the financial system in the country. These capital inflows channeled in the economy, in form of credits, through vigorous foreign owned banks, can easily increase the indebtedness of the system.
- Spillover effects of financial instability (effects of financial crisis) from other countries. High concentration of foreign capital from one country in the banking sector makes the entire financial system of the beneficiary country (country of destination), very responsive to every turmoil that the country of origin is facing.

Concerning Kosovo the origin of the foreign capital, even though at the present is highly concentrated, is going toward diversification. This conclusion derives, because, besides dominance of the capital from EU countries, which represent one distinct region in relation to Kosovo, the capital from Turkey recent years has also been gaining a significant share (by end of 2011 banks from Turkey had 14% market share in terms of value of assets). Having in mind that Turkey, from Kosovo's perspective can be considered as another different region in relation to EU, and the bad days in the EU region do not necessarily correlates or have an impact in the economy of Turkey. This comes, because, economy of Turkey is opened and historically has strong ties with Asiatic countries, apart its economic relations that has with EU countries. From Kosovo's outlook, this is considered strength, since it makes the banking sector not depending solely in one country, neither in the economies that come from the same region and share similar fortunes.

2.3.3 Concentration of banking industry

Banking market in Kosovo continuous to be characterized with a high concentration rate, given that 75 % of total banking assets are managed by three largest banks (ProCredit Bank Kosovo, Raiffeisen Kosovo and NLB Pristine). Chronologically, high concentration rate, in terms of the assets management was always the case, since the establishment of the banking sector in Kosovo (formed after the war, year 1999).
Nevertheless, since the year 2007, the continuous activity growth of smaller banks (very significant impact comes from Turkish banks), made the concentration rate to decline.
Compare to June 2010, when the concentration rate was 79.6%, the concentration of assets managed by these three banks declined by 4.6 percent, thus reducing the level down to 74.6%.

On individually bases, by end of the year 2011, three leading banks in the market had following market share; ProCredit Bank has highest share 31%, followed by Raiffeisen Kosovo 27% and NLB Pristine 15%. Whereas other four banks shared among themselves 25.4% of the remaining market share. This can be seen on the following table, which presents the value of each bank's assets on absolute terms.

Table 9. Market Share of Top -3 Banks (% of Total Assets 2011) in Banking Sector of Kosovo

	Bank	**Assets of three largest banks (€ millions)**	**Bank**	**Assets of rest of the banks (€ millions)**	**Total assets of banking sector (€ millions)**
1	**Total PCB Bank**	774,538	**Total TEB Bank**	213,998	
2	**Total RBKO Bank**	683,772	**Total BKT Bank**	135,574	
3	**Total NLB Bank**	386,777	**Total BE Bank**	152,086	
4			**Total BPB Bank**	*124,430*	
	Total	1,845,086	Total	626,088	**2,471,174**
	Participation	**74.66%**		**25.34%**	

Source: Central Bank of Kosovo, *Financial Stability Report*, 2011, p. 9, Table 7.

The banking market in SEE is rather concentrated. On the group level, the five largest banks have a country weighted market share (in terms of total assets) close to 70%.

Looking on each country level, the highest rate is noticed in case of Kosovo 90%, Montenegro 79% and Macedonia 77%.

Table 10. Level of Concentration of Banking Industry in SEE Countries, Year 2010

Country	Number of banks	Number of inhabitants per banks	Market share % of 5 largest banks / assets	Average assets per bank (millions)
Average			**66.76**	
Albania	16	200,000.00	71.00	446.00
BIH	20	190,000.00	70.00	545.00
Bulgaria	20	240,000.00	52.00	1,256.00
Kosovo	8	250,000.00	90.00	306.00
Macedonia	18	115,000.00	77.30	294.00
Montenegro	10	65,000.00	79.00	294.00
Romania	42	500,000.00	53.80	2,119.00
Serbia	34	215,000.00	41.00	764.00

Source: Raiffeisen Research, *CEE Banking Sector Report 2010*, 2010, p.32, Table 23.

The table 10 gives an overview of the market concentration in the group of SEE6 countries, based on few indicators: market share of five largest banks - CR5, number of inhabitants per bank and number of banks in the country.

In most of countries of the SEE group, the concentration rate is even higher, since the average is lowered by the moderate market concentration of Serbia, where the market concentration figure is at the level of 41%. Low concentration rate, in comparison to group s average can be noticed also in case of Bulgaria with 52% and Romania 54%. All other countries have concentration rate above 70%. Table shoes that country that leads in this aspect is Kosovo, with 90 % concentration rate, which actually is far higher that other countries that follow.

In a market economy, the perfect competition is the case when none of the players in the market, are big enough to dictate prices of the products or services. This can be achieved when the market is shared among many small players, who more or less share similar size of the market and take the price in the market as it is given, without having possibility to affect it.

The other extreme of the perfect competition is the imperfect competition. A phenomenon is present in the market, when some enterprises are big enough to dictate and set prices of outputs.

If the judgment is based on these academic definitions then Serbian banking market stands closest to perfect competition, in comparison with other countries. Serbian market has the lowest concentration rate, whereas in the market are present 34 banks. On the other hand, the banking sector in Kosovo is the other extreme, and the situation in the market has characteristics of the oligopoly.

In real life of the banking industry, the high competition between smaller players - perfect competition, has pros and cons.

Pros of the perfect competition are similar to other industries, thus products and services are priced according to market forces. Those enterprises that do not have possibility to build competitive advantage and compete in the market, either on quality or price, are destined to fail and go out from the market. This fact brings all enterprises close to a point of offering products that do not differ in terms of price and quality.

The cons of the perfect competition are related to the race for market share among the banks, which are driven by motive to raise profitability. The rapid expansion of the credit at the detriment of the loan portfolio quality gives momentum to asset bubble and indebtedness in the country, which are very important factors of deterioration of the financial sector.

The competition in negative connotation, in banking industry, is also mentioned in Minsky's model about economic boom fueled by expansion of credit. He explains that competition is not always healthy in banking industry, because according to him, in addition to the expansion of the credit by the established banks, new banks may be established. The competition between two group of banks, former, to maintain the market share, and secondly to gain market share will increase even more the credit/money in the market (Kindleberger, & Aliber, 2005, p.26).

This applies to the banking industry due to it s nature, and comes in perspective especially in transition economies, whose institutions lack the experience and adequate policies to control aggressive growth strategies of old and newly formed banks.

2.3.4 Comparison of important banking sector indicators for SEE6, during the period of time 2007-2011

Table 12 shows a summary of important indicators, which represent banking sector developments in SEE 6, during the period 2007-2011. The report will help us to analyze the distinctiveness of banking sectors for each specific country in the group and bring important conclusion regarding the possible deterioration of each country's banking system because of the recent global financial crisis, which at the same time will contribute to the main topic of the study.

The indicators, selected for analysis, are most frequently used indicators and thought to serve best the purpose of the study. Hence, through analyzing development trends of the selected indicators, will be able to bring important and valid conclusions about the developments trends of the banking sector in the region and make comparison among countries which are subject of analysis.

Table 11. Banking Sector Indicators in SEE6, Period 2007-2011

Year	Country	Loan Portfolio Growth (%)	Deposit Growth (%)	Loan to Deposit (%)	NPL (%)	ROE (%)	Loan to GDP (%)	Loan to Assets (%)
2007	**SEE6**	**60.15**	**42.52**	**90.87**	**5.33**	**13.42**	**42.47**	**56.29**
	Albania	50.20	21.90	46.42	3.50	20.32	29.28	39.37
	BIH	28.40	37.53	130.90	3.20	8.60	55.04	61.21
	Kosovo	40.10	23.66	78.05	3.30	26.00	26.29	62.17
	Macedonia	38.39	32.27	84.41	7.50	11.10	31.71	51.73
	Montenegro	165.11	94.38	107.41	3.16	6.00	77.45	75.62
	Serbia	38.70	45.39	98.02	11.30	8.50	35.06	47.67
2008	**SEE6**	**28.00**	**5.01**	**109.36**	**6.57**	**8.43**	**48.92**	**64.26**
	Albania	33.50	0.70	61.50	6.60	11.35	36.00	47.56
	BIH	21.80	-1.74	149.08	3.30	4.30	59.06	69.16
	Kosovo	32.61	26.33	81.93	4.30	20.00	30.72	65.43
	Macedonia	34.09	12.36	100.73	6.70	12.50	40.39	62.18
	Montenegro	24.53	-4.83	140.55	7.20	-6.90	90.64	84.53
	Serbia	21.44	-2.74	122.39	11.30	9.30	36.71	56.68
2009	**SEE6**	**0.82**	**5.37**	**103.21**	**9.86**	**3.46**	**49.61**	**61.66**
	Albania	1.80	-3.40	64.81	10.48	4.58	37.48	50.76
	BIH	-3.10	1.79	136.18	5.90	0.80	59.09	67.41
	Kosovo	8.96	20.84	73.87	4.40	13.00	32.95	58.48
	Macedonia	4.43	7.11	98.22	8.90	5.60	42.45	60.12
	Montenegro	-14.30	-8.31	131.36	13.50	-7.80	80.41	79.24
	Serbia	7.15	14.17	114.85	16.00	4.60	45.30	53.93

(table continues)

(continued)

2010	**SEE6**	**6.66**	**7.83**	**101.53**	**13.06**	**0.42**	**50.61**	**61.33**
	Albania	8.50	17.00	60.10	13.96	7.58	40.66	49.55
	BIH	3.40	3.62	129.80	11.40	-5.50	57.34	69.17
	Kosovo	13.17	11.01	75.31	5.90	15.00	34.60	59.42
	Macedonia	7.67	13.66	93.05	9.30	7.30	44.12	56.72
	Montenegro	-8.22	-1.91	122.91	20.90	-27.27	72.78	74.74
	Serbia	15.44	3.58	127.99	16.90	5.40	54.16	58.37
2011	**SEE6**	**10.76**	**5.28**	**107.12**	**17.48**	**0.58**	**50.34**	**64.91**
	Albania	9.00	6.00	62.18	17.00	2.40	n/a	n/a
	BIH	7.00	0.60	161.95	11.80	3.50	61.37	73.19
	Kosovo	11.39	6.40	75.64	5.90	13.00	35.12	63.09
	Macedonia	7.72	5.58	94.93	9.80	n/a	n/a	57.41
	Montenegro	n/a	n/a	n/a	23.00	-23.00	n/a	n/a
	Serbia	18.69	7.83	140.88	18.10	7.00	54.55	65.93
Average	**SEE6**	**21.28**	**13.20**	**102.42**	**10.46**	**5.26**	**48.39**	**61.69**
	Albania	**20.60**	**8.44**	**59.00**	**10.31**	**9.25**	**35.85**	**46.81**
	BIH	**11.50**	**8.36**	**141.58**	**7.12**	**2.34**	**58.38**	**68.03**
	Kosovo	**21.25**	**17.65**	**76.96**	**4.76**	**17.40**	**31.93**	**61.72**
	Macedonia	**18.46**	**14.20**	**94.27**	**8.44**	**9.13**	**39.67**	**57.63**
	Montenegro	**41.78**	**19.83**	**125.56**	**13.55**	**-11.79**	**80.32**	**78.53**
	Serbia	**20.28**	**5.71**	**126.53**	**15.58**	**6.58**	**47.68**	**58.73**

* Non Performing Loan - Loans in default (past due) over 90 days

**Return on Equity

Financial Intermediation - Banking activity in SEE is dominated by traditional banking (collecting deposits and giving credit). The share of loans to total assets in SEE6 countries is above 60 % .Whereas the loan to deposit ratio is just few points above 100%. This indication bring to the conclusion that finance of the lending activities is done mostly from the local deposits, whereas on the assets side of the balance sheet, the most dynamic activity is credit.

The average ratio of loans to assets, for the entire group, varied from 56% on year 2007, to 65 % at the end of the period. The variation can be noticed also among the years, which are covered in the period of time. For example, the jump for the group's average can be

noticed, in year 2008 and then a sudden drop happened in 2009 as a consequence of the credit crunch that happened due to the impact of the financial crisis.
There are some deviations from the group's average, on country level, thus Montenegro and BIH are standing above the average, concluding that in these countries lending activities play more important role than, for example, in Albania and Macedonia whose ratio is below the group s average. Kosovo in this sense is the country that stands closest to the group s average, but with interesting variations during the years. Kosovo has the sharpest drop on year 2009, phenomenon that did not come only as a result of slowing down of lending activities, but also as a result of the increase in the other items (excess liquidity) of the asset side of the balance sheet, due to continues increase in deposits.

Asset Growth dynamics (Assets growth , Assets to GDP) - Looking at assets growth dynamics during the period of time 2007-2011, the banking sector in SEE6 was characterized with the deceleration on the assets growth trend, during all years that preceded year 2007. In year 2007 the average assets growth for the group was 40%, whereas on following years the ratio drop to 12 % in year 2008, whereas in 2009 the growth rate has hit the floor, compare to all other years. Hence, in this year the assets growth was only 4.3%, which is almost eight percentage points down from one year before, or 34 percentage points from year 2007. The growth trend started to take momentum again in 2010 and followed with almost same dynamic in 2011.

In 2009 the effects of the financial crisis, has been reflected on the slowdown of the banking and generally in economic activity. In some countries, the year 2009, has ended by noting decrease on the value of assets. For example, Albania, BIH and Montenegro all had negative trend of the assets growth on year 2009, whereas all other countries has experienced declining trends.

In regards to this indicator, Kosovo has shown the most stable systematic growth for the entire period. Even though the drop in the year 2009 is evident, and continued on the following years, Kosovo is the second country that had largest cumulative increase of it s assets during the period. It has reached the growth of 21%, a result that is much higher than the group's average. Kosovo has also shown stability on increasing it s value of assets in relation to GDP. The ratio of assets to GDP in 2007 was 42%, thus in 2010 the ratio increased to 55.6%.This means that banking sector in Kosovo increased faster than other sector of the economy.
Positive result concerning this ratio (assets to GDP) has been registered in other countries, in Macedonia, Albania and Serbia, too.

Montenegro has the largest cumulative growth on the banking asset during the period; nevertheless, Montenegro has the most incoherent trend and has the highest variations between years. The average result was very much affected from year 2007, when the growth exceeded 100 %, whereas the following years, it faced a very steep plunge, 11% in 2008, and negative results for all coming years, until end of 2010. Montenegro along with BIH are the only countries that had decreasing rate of value of the assets in relation to their GDP.

Based on the indicator of growth dynamics of the assets, this shows that:

- The year 2009 was the year when the region has experienced the lowest point on decrease of the growth trend. Therefore, it is considered as a year when the waves of the financial crisis have reflected on the economic and financial activity of the region.

- Montenegro and BIH are countries that have been affected mostly by the financial crisis, while Kosovo had experienced the mildest consequences.

Lending and deposits trends (Loan and Deposit portfolio growth, loan and deposit to GDP , loan to deposit ratio, comparison of indebtedness based on loans to GDP, quality of loan portfolio) - The credit growth trend, in general, has followed the same developing trends, as asset growth explained above. This is natural, taking into consideration the role and high participation of this item (loans to clients) in the asset side of the bank's balance sheet.

Pre crisis lending growth was on double digit in all six countries of SEE (year 2007 and 2008). The average growth rate, for the group, in 2007 was 60%, a result that is considered very high. Montenegro is the country which contributed on this ambitious growth (160% growth rate in Montenegro), followed by Albania with 50% and Kosovo with 40%.

In 2009 the loan growth turned to single digit for the group's average, while in some countries the result was even negative. The stagnation of loan portfolio growth prevailed during the next year 2010, whereas year 2011 recorded optimism when the growth average turned to double digit.

From all the countries in the group BIH has realized the lowest growth, during the period of time 2007-2011.While Serbia and Kosovo has shown relative stability in regards to growth trend of the credit.

It is worth mentioning that the situation, of growth inconsistency of Montenegro, is repeated again, also with this indicator. Looking on the aggressive growth trend of Montenegro in 2007 and sharp drop in the next three year, we can conclude that banks in Montenegro had faced credit crunch, phenomenon that it has been evident also in other countries, but not as much as in Montenegro.

The growth of credit in Kosovo has followed the group s average (Kosovo is on exactly same growth rate as a group s average of 21%). Nevertheless, if we exclude year 2007, when the average that year has been increased mainly due to contribution of enormous growth rate of Montenegro (160%), and analyze other years (2008-2011) it is obvious that Kosovo's performance of 16% is much better than group's average of 11%.

Even though the lending growth faced stagnation during the crisis years, it has outpaced in all terms the deposit growth. All countries have increased more their loans than deposits. Perhaps in some of the countries, the slower growth trend of deposits in comparison to loans has later resulted on reducing the growth speed of the loan portfolio. This might be a case, especially, in countries that have used credit lines from their parent banks or other banks in Europe to finance their lending activities. As the crisis hit the Europe, the interbank lending has crunched due to liquidity problems; therefore same liquidity problems has been passed over to the banking sector of countries which already had higher loan portfolio then deposits and could not extend the usage of these credit lines.

Looking on loan to deposit ratio, BIH and Montenegro have this ratio higher that 100% (higher loan portfolio than deposits from clients). Assuming that the aggressive lending strategy in BIH and Montenegro, in pre crisis period, has been financed from credit lines from abroad. As the credit lines stopped, there was no choice left except slowing down lending activities. Recalling the asset growth indicator, Montenegro and BIH had lowest growth of assets during the period 2007-2011. In case of Montenegro, the conclusion applies if we exclude year 2007, when this country registered very high growth on banking assets.

In this regard Kosovo and Albania have position that is much more favorable. Both countries have financed their lending activities from local sources, hence the loan to deposit ratio in these two countries never exceeded 85%.

The loan to deposit ratio in case of Kosovo, for the whole period, was balanced at around 75 - 81%. In 2007 and 2008, which for Kosovo are considered as pre crisis years and loan portfolio was expanding at high speed, the loan to deposit ratio was at the highest-level 78-81%, and nevertheless this figure was well below the group's average. On coming years, when the loan portfolio growth dynamic declined, the ratio of loans to deposit decreased at the level of 75%.

Having ratio at this level is in accordance with the Central Bank of Kosovo requirements. This is a strong recommendation from the supervisory authority, since Kosovo's banking sector in comparison to other countries, have limited and more expensive access to foreign capital. This comes because of several factors, however political situation, lack of market rating for Kosovo and immature financial system, being as most prevailing factors.

However, we consider that this is one of the factors that Kosovo has been entrenched from the contagion effects of the financial crisis. It had no difficulties on expanding loan portfolio, though at declining trend during the crisis years, it is still larger compare to other countries from the region. Had not been tightening of credit standards due to increased conservatism of the banks because of global financial crisis, deposit market in Kosovo could have supported without problem, even at faster pace the growth of loan portfolio. In other words, domestic deposits played an important role on increasing immunity of Kosovo from contagion effects of crisis in other countries and supported better performance of Kosovo in terms of profitability. In regards to both these indicators, Kosovo performed much better compare to other countries in the group.

Having domestic deposits, as a source to finance lending activities, has two positive perspectives;

- It affects directly banks profitability, since limited domestic deposit collection under normal circumstances reduces bank's profitability. It comes as a result that banks normally pay lower interest rates to depository clients then to other forms of finance from abroad.

- It diversifies risks, since banks are not depending only on credit lines, as a source of finance, from limited number of other banks. In this case, these banks can cut these credit lines, at any time, and put the borrowing bank at difficult position in terms of liquidity. Whereas deposits are coming from very large number of local depositors, therefore, the liquidity can be managed much better and the probability for losing the depository base is much lower than loosing credit lines from other financial institutions.

Profitability of banks is closely related to the performance of the loan portfolio in terms of the quality. The provision expenses dedicated for covering losses due to loan portfolio impairment for bad loans, presents an expenditure that has significant share in the Profit and Loss (hereinafter: P&L) statement of banks. The provision expenses for loan portfolio quality have significant importance in the bank's P&L, particularly in times when banks face deterioration of their loan portfolio in terms of quality.

In our case, countries, which have had problems with profitability, are the same countries that have highest loan to deposit and Non Performing Loan (hereinafter: NPL) ratio. As the crisis escalated, there was a steep decline on profitability in all countries. However, Montenegro, BIH and Serbia are countries, which have lowest Return on Equity (hereinafter: ROE) during entire period.

Montenegro and BIH performance in regards to this indicator was lower than the group's average, while Serbia had slightly better performance than the group's average. The group's performance for the period was 5.6%, while Montenegro s banking sector had average ROE-11.79 % respectively 2.34% for BIH, whereas Serbia has slightly better indicator than the average, 6.5%.

Interesting enough, all three countries (Montenegro, Serbia and BIH), which distinguish themselves as countries with lower ratio of ROE, are already the same countries which have ratio of loans to deposit over 100%, and highest NPL ratio.

This assumes two fundamental causes for this result;

- primarily, higher cost of funding as a result of significant share of other forms of finance besides local deposits, and
- secondary, higher provision expenses because of low quality of the loan portfolio that later affects the profitability of the banks in these countries.

The rapid increase of NPL correlates with the effect of the crisis in the region and economic recession that some countries were going through. Another factor that has influenced the bad performance of loan portfolio quality is level of indebtedness in the country, measured by Loan to GDP ratio (last column of the table). As we can see from the table, the level of indebtedness corresponds with countries, which had and are having problems with loan portfolio quality. Countries, which are having problem with NPL ratio, are Albania, Montenegro, and Serbia and to some extend BIH. These countries, excluding Albania, are same countries, which have higher than average level of Loan to GDP ratio.

Montenegro is the country that had highest jump on NPL ratio. It has started the period with 3% ratio of NPL, while the ratio on year 2011 reached the level of 23%. Besides other factors, which are closely related to the economic recession that this country was experiencing, Montenegro has started the crisis period with highest level of loans to GDP ratio, meaning that on pre crisis years Montenegro has build indebtedness as well as risky loans during the period of lending booms.

NPL have since then stabilized, except in Montenegro. Nevertheless, it remains above the pre crisis level in all countries. Whereas some of the countries are having serious problems, since the increase is very high, thus the recovery period might take longer. In 2007, the average NPL ratio of the group was 5.33%, while in 2008 the average of group had slightly increased to 6.5%. However, the quality of loan portfolio deteriorated ever since the year 2009, hence increasing at the level of 9.8 % and continuing at the same pace during the next two years , reaching the peak 17.5% in 2011.

Kosovo is the country that had by far lowest share of nonperforming loans to gross loan portfolio, compared to other countries. Kosovo started the period with 3.3% NPL, figure which is not far from the groups average on this year (in 2007 the group s average was around 5%), nevertheless the debt servicing capacity as a result of slackened economic activity and high increase of the loan portfolio on pre crisis years , hit much harder other countries than Kosovo.

2.3.4.1 Calculation of median for selected indicators - statistical model

A detailed analysis of indicators of banking sectors will be conducted on the section to follow. Most of the selected indicators are those used in the previous table. The table is separated in two parts:

The left part of the table presents indicators, which show the situation of the banking sector before and after the financial crisis. Based on calculation of the median for each specific indicator on group level, the countries will be ranked according to the impact they have experienced from the last financial crisis.

Since these indicators will be used for estimation purposes, the separate calculation of the median on the group level will be conducted for each indicator. Than a magnitude from **minus three** (-3) **to plus three** (3) units is given to each position in order to see the deviation of each country from the median position of the entire group. Hence, a value of minus one (-1) to minus three (-3) are assigned to all countries, depending from the country's rank in regards to the group median. Assuming that countries that rank below the median are countries that have been utmost affected from the financial crisis, in regards to specific indicator.

Whereas positive values from one (1) to three (3) are given to countries, which have position above the median assuming these countries have been the least influenced from the financial crisis. Then the sum total of points for all indicators concludes the final rank of the countries, and the degree of the financial crisis impact on each and specific country (these calculations are shown on the annex 1).

The following will explain selected indicators, how the calculation for each indicator has been conducted and logic behind the method used, whereas the details about the calculation are shown in annex 1.

- Deposits growth **-** shows the average growth of deposits in the country, for the period of time 2007-2011. Assuming that the average measure, calculated for the actually period concerning the deposit is a reliable measure for comparing the development trend in different countries growth.

- Loan portfolio growth **-** shows the average growth for entire period, on country bases. Similar to previous indicator, the average growth of loan portfolio, for the period, represents good base for comparison development of this indicator among different countries.

- Ratio of NPL to gross loan portfolio **-** regarding the third indicator, is calculated difference between the value of NPL on the first and last year of the period. However, the difference will show the magnitude of portfolio quality deterioration at the end of the period in comparison to the beginning of period.

- GDP growth**-**it is the best indicator to represent the economic growth in the country. In our calculation is used the difference between year 2007, which represent the first year of the period (in our assumption pre crisis year, and year 2009, considering that this year was the time when financial crisis hit the region. Thus assuming that all the period after year 2009 (2010 - 2011) are recovery years.

- ROE**-**it is calculated as a relative difference, for the period of time 2007- 2011, taking the year 2007 as a base year, assuming that the simple difference will not be able to represent the reality, in regards to this indicator. Therefore, the relative difference between year 2007 and 2011 is taken as a base for our calculations.

Whereas on the right part of the table are positioned indicators, which we consider as possible causes of creation of vulnerabilities on the banking sector. For the purpose of our study, we are interested on their values before the crisis hit the region. In other words, these indicators present the fundament for raising sub hypothesis, adjusted accordingly to the situation of SEE6 countries, which are in line with the main hypothesis and will be in the function of testing it.

Recalling the meaning of the main hypothesis of this study about capital surges as an ultimate cause for capital crisis and the role of local regulators on controlling the downscale of the capital into the national economy, these sub hypotheses will assume that:

Sub hypothesis#1-countries with traditional banking sector, collecting deposits and giving loans, hence not having developed advance banking products in the market, has shown higher immunity from the impact of the financial crisis. This is so, because simple traditional banking enables banks as well as regulators to control closely banking activities, since it makes risk more transparent and traceable.

Researching the reality of the banking sectors in SEE6 countries, and proving the validity of this sub hypothesis, we want to show that countries that are far from this reality, are more prone to financial crisis. The ratio of loans to total assets and loan to deposits will give a picture of the structure of financial intermediation in each country.

Sub hypothesis # 2-banking system of countries which base the finance of lending activities on local deposits are more stable than banking systems of countries which have dependence from funds out of the country in forms of credit lines from international financial institutions.
The ratio of loans to deposit will show the level of dependence of each country from foreign funds. The assumption is that financial systems of countries that have higher level of this ratio consequently had experienced stronger impact from the last financial crisis.

Sub hypothesis #3-banking sector of countries, which have higher competition, are more prone to effects of the financial crisis. Because higher competition is a strong reason for banks to take more risk, many banks under pressure to increase profitability give a push to lending activities;hence, they end up financing risky investments. Taking into considering the market concentration of five largest banks in terms of volume of assets, it will give us estimation about the level of competition in these countries, thus assuming that countries, which experienced highest impact from the financial crisis at the same time, have had higher competition in the pre crisis period.

Sub hypothesis # 4 -Higher loan to GDP ratio means higher level of indebtedness in the country, hence results on vulnerability of the financial systems. The logic behind this assumption is that as higher the indebtedness level in country is, the higher the probability of loan portfolio deterioration should the country faces economic problems. Based on this assumption we will prove that excess liquidity in the market if not followed with prudent regulatory policy, might end up on over indebting the private sector (companies and households).

Sub hypothesis # 5 - countries that have higher concentration of the origin of the founding capital in the banking sector, due to contagious effects presents more risk, than countries that have higher level of diversification in this regards.

The research will be in the function of proving the validity of the above sub hypothesis, because this is the way will come to very important conclusions about the validity of the main hypothesis of the study. Therefore, by using the results from this analysis, countries will be categorized accordingly based on the impact they had from the last financial crisis.

Initially, countries that have been influenced utmost will be ranked in one extreme and those that had experienced least influence by the crisis, in other extreme. Afterwards the possible causes will be analyzed, for most extreme cases ,either on negative meaning (those that had largest impact) or positive meaning (those that avoided effects of the crisis), if they are in the line to the above mentioned sub hypothesis.

Table 12. Matrix Based on the Calculation of Variation of Each Individual Country from the Group's Median, for Group of Selected Indicators.

Results according to selected indicators							**Indicators which are assumed as causes**			
	Deposit Growth	Loan Growth	NPL	ROE	GDP Growth	**total points**	Loan / Deposit (%), pre crisis 2007	Loan to GDP (%) pre crisis 2007	Higher competition /concentration (%)	Average number of inhabitants per a bank.
Kosovo	2	3	2	2	3	**12**	78	26	90	250
Serbia	-1	1	1	3	-1	**3**	98	35	41	215
Macedonia	1	-1	3	-2	1	**2**	84	32	77	115
Median						**0,5**				
Albania	-2	2	-2	-1	2	**-1**	46	29	71	200
BIH	-3	-2	-1	1	-2	**-7**	131	55	70	190
Montenegr	3	-3	-3	-3	-3	**-9**	107	77	79	65

Based on the calculations presented in the above matrix, we conclude that Montenegro and BIH are the most affected country from all other countries in the group. Montenegro is positioned the last country below the median, since it has minus nine points below the median, while BIH as second last country has minus seven points below the median.

Why is Montenegro ranked in the last position on the above statistical calculations?

It has the lowest ranking from all other countries in the group related to four out of five indicators (Loan growth, NPL, GDP growth, ROE).
Montenegro has started the period with enormous growth (over 100% in 2007), at the same time as the crisis hit the region, after year 2008. It is the only country that ended the period with decreasing trend or negative growth of banking sector assets,.(as for Montenegro, the end of period is used year 2010, since there were no available data for subsequent years).

Montenegro is also one of the two countries that decreased the value of its assets to GDP, during the period of time 2007-2010. Despite negative development of assets, Montenegro also has worst performance regarding other indicators, it has one of the lowest GDP growth for the period (if we exclude year 2007, the average is lower and at the same time the lowest from all other countries), has highest NPL ratio and banking sector had worst performance in terms of profitability indicator.

All these facts conclude that Montenegro has been most, from all other countries, which are subject of comparative analysis, hit from the last financial crisis, hence in our statistical calculations represent the negative extreme. What is worth mentioning related to

Montenegro is that the impact is lasting longer, due to the fact that is the only country from the group that negative growth is prevailing even at the end of period (year 2010).

What are the factors that rank BIH below the median?

Similar in BIH case, four out of five indicators has resulted below the median, thus only one indicator ranked one positive point above the median.
According to indicators that show assets development; assets to GDP and growth ratio, BIH has lowest growth rate from all other countries in the group. Similar to Montenegro, it has reduced the ratio of assets to GDP and the stagnation is lasting ever since the year 2009, when the region started to feel the impact from the global financial crisis.

BIH position is bad also in terms of other indicators, such as profitability and quality of loan portfolio. Its loan portfolio to private sector has been increasing faster than the economy itself, which means that BIH has increased the indebtedness of the private sector during the period of time 2007-2011.

Accumulated values of indicators prove that Kosovo's financial system represent the other extreme, on positive meaning. Kosovo's financial system has the least deterioration in comparison with other countries. All other indicators in case of Kosovo are ranked above the median. The accumulated points could have been even higher, but the method how we calculated the third ratio (difference 2007-2011) puts Kosovo in disfavor position. In regard to this, even though Kosovo has lower ranking in term of NPL, comparing with Macedonia, Kosovo has much lower NPL ratio, 5.9% by end of 2011, then Macedonia that has the ratio of 9.8%.

Conclusion about sub hypothesis - according to previous results ranking Montenegro and BIH as countries that have been hit to the utmost by the financial crisis, whereas Kosovo as a country, which had least impact, most of our sub hypothesis proves to be right**.** Based on the above discussed sub hypotheses, countries which have higher loan to deposit ratio (financing their lending activities from foreign funds), higher ratio of private sector loan portfolio to GDP ratio (level of indebtedness in private sector), are weaker and more prone to crisis effects. This is so, because of the reasons, which were already explained on the previous sections. The competition factor is also taken into account as a reason to set preconditions for banking crisis. Since banks are racing for the market share, therefore they increase their risk taking appetite, which latter might decrease the loan portfolio quality.

Interesting enough these causes are evident in three countries. For example, both countries that took the lowest position in the chart are considered to have most problems, and had higher loan to deposit ratio than other countries, at the beginning of period (Montenegro 107% , BIH 131%), and higher loan to GDP ratio, Montenegro 77%, respectively 55% for

BIH. Whereas Kosovo, which is the other extreme, in regard to financial and economic stability is one of the countries that have lowest loan to deposit ratio 78 %, and the lowest level of indebtedness. Its loan to GDP ratio stood at the level of 26 % which is the lowest ratio in the group.

As for Kosovo and Montenegro, as well as in case of BIH, it proves right also the assumption that higher competition in the banking sector might be harmful for the entire system. Kosovo has highest level of concentration of five largest banks, at the level of 90%, and largest average of banked population. This average shows that Kosovo, on every 250'000 inhabitants has one bank. While according to this average, Montenegro, has highest level of banked population, hence in Montenegro there is one bank per 65'000 people.

As the analysis describes, from the perspective of comparative analysis, we have proved that excess capital in the national market due to capital surges, is a fundamental cause for deteriorating the economic and financial system. This assumption is even stronger in case of transition and emerging countries, when capital inflow booms were followed by lack of experience of local institution and imprudent macroeconomic policy.

Nevertheless, to strengthen the conclusion of the study, particularly in case of Kosovo, we will continue our study with empirical research on the micro level, just in order to finalize our final assumption.

3 BALANCE SHEET ANALYSIS OF SMALL AND MEDIUM ENTERPRISES

3.1 Objective of the study

The objective of this empirical study is to prove, from the micro level perspective, the hypothesis that from the macro perspective has already been proved right, that Kosovo s financial and economic system has shown stability, and from all other countries in the region it felt the least impact of the global financial crisis.

In searching for whether the above-described hypothesis, is right, a balance sheet analyses for a sample of more than 200 Small and Medium Enterprises has taken place. According to Kosovo's standards, the number of employees, value of assets and yearly turnover are used as criteria for categorization of enterprises into Small and Medium Enterprises.

In category of Small Enterprise are selected following enterprises: those that have up to 10 employees, yearly turnover from 50'000€ up to 2 mil €, value of assets from 25'000€ up to

1 mil €. Whereas, in the category of Medium Enterprises are categorized, those enterprises that have: 10 - 50 employee, yearly turnover from 2 mil € to 4 mil €, value of assets from1 mil € to 2 mil €.

The aim of the study is to gain an understanding of the financial statement development through the period 2007 - 2011, of those types of enterprises, which comprises the most important sphere of the economic life.

A certain set of ratios is selected, in order to measure and analyze changes on the financial position of these enterprises. The following ratios which serve as a tool to measure changes, on leverage, gross yearly turnover, leverage, repayment capacity, liquidity, development of some important balance sheet items (inventory stocks and fixed assets), will help us to derive conclusion regarding, the possible effects of the financial crisis, on the business environment of the country.

3.2 Methodology

The study was conducted on a set of enterprises, which are regular clients of ProCredit Bank Kosovo. The clients which do consider ProCredit Bank Kosovo as a home bank for their businesses used to have regular credit history on yearly bases with the bank, and what is most important for our study is that their financial statements has been updated at least once a year. The updated position of financial statements is the core importance of the study, since it enables us to compare the development of their financial positions on yearly bases.

Because, ProCredit Bank is leading bank in Kosovo, and it s market share is significant for the banking sector in the country, the sample taken from it s database is thought to be a reliable reflection of the overall situation of the business environment in Kosovo. By the end of December 2011, the market share of the ProCredit Bank Kosovo, in terms of loans and deposits was slightly above 30 % (for loans 30.8% , respectively 31.65 % for deposits) or in other words approximately 1 € in every 3 € of active loans and deposits in Kosovo belongs to ProCredit Bank.

However, in reality, this participation is even more significant, when it comes to credit relations with number of businesses that are active in the market. ProCredit Bank might have only 30 % market share in terms of the loan portfolio of the banking sector, but in those 70% remaining, there are clients who have credit relations with more than one bank.

The sample is comprised from enterprises, which have more than ten employees, and as explained above, bank has regular update of their balance sheet. According to ProCredit

Bank's definitions, these enterprises comprise the segment of Small and Medium Enterprises.

Two methods for collecting data, from the bank s database, are used in order to increase the objectivity and accuracy of the results.

- The first method of collecting data uses a sample of enterprises, drawn from each administrative region in Kosovo, from different sectors of economy, having always as a main criteria for selection enterprises that have more than ten employees and have regular credit relations with the bank.

Administrative Region, according to ProCredit Bank organizational structure, represent the main and biggest administrative separation in the field. Therefore, based on bank's organizations standard, Kosovo is separated on seven main administrative regions in accord with seven main cities in Kosovo; Prishtina, Mitrovica, Peja, Gjakova, Prizren, Ferizaj and Gjilan.

The sample contains data from 279 enterprises, for the period of time 2007-2011.Whereas participation from each region is as follows; Prishtina Region participating with 60 enterprises, Mitrovica Region with 39 enterprises, Peja Region with 42 enterprises, Gjakova Region with 27 enterprises, Prizren Region with 40 enterprises, Ferizaj Region with 34 clients and Gjilan Region with 37 clients. However, the distribution of sample according to business activity is as follows: 32 enterprises are operating on construction business activity, 46 on production business activity, 54 on service business activity and 147 enterprises on trade business activity. Thus the sample, despite reflecting the overall trend of financial situation of enterprises in Kosovo, gives also an understanding of the business developments in the regions and represents a good base for making comparison of performance among different economic sectors.

The information is gained in form of questionnaire (see appendix 2), prepared by the author, delivered and asked to be filled by responsible Business Client Officers, using credit analysis form of actually clients/enterprises, as a source for collecting requested information according to the questionnaire. **Credit Analysis Forms** are in form of the questionnaires, filled up by the credit analyst, in order to prepare the financial report for the company, which latter on will serve as a base report in the **credit committee** (in this case the decision making body) to assess the creditworthiness of the client.

The main aim of the first method was to assess the level of indebtedness of the enterprises selected in the sample. The level of indebtedness in this case will be measured using ratio of net ***indebtedness index***, which is calculated using the following formula:

$$Indebtedness\ Index = \frac{total\ monthly\ installments}{net\ monthly\ income\ of\ company}\text{......................}(1)$$

Since most of the loans, which comprise the loan portfolio of ProCredit Bank, are installment loans, the Net Indebtedness Index is used as a measure to estimate the payment capacity of the company. Thus according to bank's standards for preparing financial statements of loan applicants, particularly for small and medium enterprises, monthly loan installments that companies are obliged to pay on monthly basis, are considered as cash outflow, deducted from the company's monthly disposable fund.

Our second method of collecting data has used, as a source, directly the bank s database. The financial statements of enterprises, for the period of time 2007-2011, which has been processed in the bank s custom ware, were exported into excel file.

These financial statements are real empirical data, as they were prepared and verified on the field by the credit analysts, in order to assess the creditworthiness of the loan applicant/company, whenever they applied for a new loan. The accuracy of this information is considered quite reliable, since the decision on credit committee depends completely on these financial statements. However, taking into consideration the level of informality that prevails in the business environment of Kosovo, we should provision for a certain degree of possible inaccuracy, when it comes to the outputs of the study.

Furthermore, two main criteria has been used for filtering and selecting the sample; first criteria, was regular update of their financial statements on yearly basis, and the second criterion was the number of employees, thus selecting enterprises which have more than 10 employees. From a mass of approximately 5000 enterprises, the number was reduced to 280 enterprises, which gave us a sample for our analysis.

The objective of the second method was analyzing some of the financial ratios, in order to find out the evolution of following items; turnover, profitability, development of receivables, fixed assets and stocks/inventory management. Through analyzing these ratios, we will use a standard comparison of items on the company's financial statements rather than a direct reading of the financial figures. Though the results of the analyses will reveal how the company's performance has evaluated during the period of time 2007-2011, assuming that any major negative deterioration is a reflection of the effects of the global financial crisis.

3.3 Over indebtedness measured by indebtedness index

Table 13 shows the result of the development of the indebtedness index, for the period of time 2007-2011. The ratios reflect how much of company's net income is going for debt servicing (payment of installments). Hence, if the ratio is 0.50, it means that 50% of company s income is used for repayment of installments, in all banks.

Table 13**.** Results of Indebtedness Index Calculated for Enterprises in the Sample, According to Regions and Business Sectors

According to Region							According to business sector						
	Year	**2007**	**2008**	**2009**	**2010**	**2011**		**2007**	**2008**	**2009**	**2010**	**2011**	**difference 2007-2011**
Region	**No. of firms that stopped activity**	1205	943	1136	1363	878	**Sector**						
Prishtina		0.42	0.44	0.41	0.49	0.57	**Trade**	**0.48**	**0.57**	**0.63**	**0.63**	**0.64**	
Prizren		0.44	0.50	0.57	0.55	0.65	Y to Y difference		0.09	0.06	0.00	0.01	0.16
Peja		0.54	0.67	0.95	0.91	0.73	**Production**	**0.36**	**0.45**	**0.57**	**0.66**	**0.77**	
Gjakova		0.45	0.48	0.68	0.84	0.74	Y to Y difference		0.10	0.11	0.09	0.11	0.42
Gjilan		0.44	0.39	0.43	0.51	0.51	**Service**	**0.41**	**0.48**	**0.42**	**0.47**	**0.53**	
Mitrovica		0.48	0.59	0.56	0.59	0.61	Y to Y difference		0.07	-0.06	0.05	0.06	0.13
Ferizaj		0.39	0.43	0.48	0.49	0.54	**construction**	**0.55**	**0.54**	**0.58**	**0.79**	**0.88**	
Average for Kosovo		**0.46**	**0.53**	**0.57**	**0.62**	**0.67**	Y to Y difference		-0.01	0.04	0.21	0.09	0.33
Year to year difference in the indebtedness index			**0.08**	**0.04**	**0.05**	**0.05**							
	Difference on average indicator 2007 – 2011					**0.22**							

The left part of the table, presents results according to the region, thus the indebtedness index is calculated separately for each particular region. At the bottom of this part of the table is calculated the average indebtedness index, for all regions on yearly bases, the difference of the average measure from year to year, and at the very last row is calculated the sum total of difference of the average measure between year 2007 and year 2011.

A very important information on the table is also the number of enterprises that shutdown their activity on yearly bases. The right part of the table shows the results separated according to business sectors, and for each sector is also calculated the difference of variable between present and previous year. As the table 14 shows, the number of enterprises that terminated business activity was growing until year 2010, when it has reached the peak. The trend fits quite well to the overall business dynamic in the country, which decelerated in year 2009 and 2010. Recalling the trend of the nonperforming loans to total Gross Loan Portfolio, the year 2010 registered the peak about this ratio, explained by the possible difficulties that private businesses were facing this year.

Turning to the movements of indebtedness index, we will first look at the movements of this variable, throughout the period, for the entire sample. Based on the correlation that this variable - indebtedness index has with the risk of default (as higher the index is, as much higher the probability that company will default on repayment of its debt) the enterprises were classified into three groups. Always depending on the calculation for each unit, of what share has debt servicing in total net income of the company. The discussion on higher level uses the same concept of classification, extending the calculation as the average for the region, year, and entire sample.

Therefore, the classification uses following criteria:

Not over indebted - if the company spent less than 50 % (indebtedness index up to 0.50) of the company s income on repayment of installments.

Risk of becoming over indebted - the net indebtedness index is between 0.50 and 0.75.At this range enterprises are not yet at the critical stage; nevertheless, there is high risk that company is going toward that direction.

Critical stage - when the net indebtedness index is over 0.75, then the enterprises, already, are on the red zone.

The above classification is based on the experience developed from the bank throughout the years of operating in the country. Since Small and Medium Enterprises usually are facing capital constrain, due to their size, increase of expenses dedicated for repayment of credit obligations might risk their solvency. The logic is simple; higher value of the indebtedness index higher the probability that company will face insolvency.

A same criterion for classification applies, on the same logic, when we talk about averages for other units: not over indebted, risk of becoming over indebted, critical stage; years, regions etc.

Looking on the figures of the indebtedness index for the entire sample, we can see that in 2007, the average was standing at 0.47 points. Thus concluding that this year, enterprises in Kosovo were in the category of **not over indebted**, since only 47% of their net income went on servicing repayment of installments. One year later, on year 2008, the index increased for eight percentage points, and continued positive dynamic also on the next two years, though with slower growth dynamic. Actually, in 2008, the indebtedness index exceeded the limit of 0.50, therefore that year enterprises have moved one category upward, actually on the category of **risking for becoming over indebted**. They remained on the same classification for the next two year. Nevertheless , the index denoted increase within the same category ,and in 2011 it reached level of 0.67 point, figure which is approaching the ceiling limit of the actually category.

In terms of regions, we can see that throughout the whole period, enterprises from Peja and Gjakova Region have their indebted index over the country's average. Enterprises in these regions stand two percentage points in case of Peja, respectively one percentage point in case of Gjakove, away from moving into **critical stage/category.**

Information on the right part of the table shows movements of indebtedness index about business sectors. As the evidence above shows, two sectors have higher mobility of the index through the period 2007- 2011; these activities are construction and production sector. Enterprises that operate in this sector started the period with indebtedness index of 0.36 for production enterprises, respectively 0.55 for enterprises that operate on construction activity. As table shows, even at the beginning of the period, construction enterprises have had relatively higher index, compared to other sector, while production enterprises from all other sectors stood at most favorable level.

Nevertheless, both these two sectors noted the highest mobility during the period of time 2007-2011.The critical stage is the rank of enterprises that work on construction sector in 2011, thus standing at point of 0.88, in terms of the value of indebtedness index,. This fact categorizes the construction sector as the most risky sector, thus also having being hit at the utmost by the possible effects of the financial crisis. Since, as the study concluded before, in Kosovo there were not major surges of capital, construction sector might already show the endogenous development of the financial crisis, which was stopped by eruption of the global financial crisis.

At the second worst place, in terms of the value of indebtedness index, with 0.77 points, is positioned production sector. In reality production sector has noted even higher increase on the index level than construction. Nevertheless, this sector is ranked one position below the construction, because it has started the period at much favorable position. The actually situation of the production sector could be explained by the nature of this sector and weak position of productions enterprises in Kosovo, inherited because of the damages caused by the war. Most of the production firms in Kosovo has started to build their assets from the scratch, therefore they needed to invest constantly in production capacities in order to be able to survive in the market. Since these investments were financed by credits, it has directly increased their indebtedness.

From these analyses, derives the conclusion that overall business environment in Kosovo, in terms of repayment capacity of credit installments, for the time being stands at comfortable position. Enterprises in Kosovo, considering overall results, are not over indebted. For the moment they are position at the level below 0.70 points, whereas the index, for the period 2007-2011, have increased on average by 4.4 percentage points each year.

Nevertheless, the future might bring other problems. If demand in the market does not increase with higher pace, at the time when investments, be it in the level of the company as a micro unit or for the entire economy are needed desperately, the present level of indebtedness index in future does not give much space for further leverage.

Whereas in regards to the topic, if enterprises in Kosovo as an micro unit, reflect any possible effects from the financial crisis, the results shows the opposite or shows similar trends as the analysis of the financial indicators on macro level concluded. Though the actually increase on the indebtedness index shows, rather a reflection of increase in the credit portfolio in the banking sector, than any significant decrease on indicator or company's net income, as a result of economic slowdown.

More or less same situation repeats on the second ratio, which shows the profit indicator. Thus, the net profit has continuously decreased throughout the years, within the period of time 2007 - 2011, in relation to total assets.

The decrease of this ratio might happen because of several factors; higher increase of the balance sheet items (in this case assets), relative to increase on company's sales and profit, or, because of decrease in the absolute values of sales which later affected the profit. Nevertheless, taking into consideration the other ratios, which show the development of other balance sheet items, the conclusion is that decrease on P&L ratios appeared because of both factors.

The results on the table show that the ratio of debt to equity increased for 9.21%. This gives us an understanding that enterprises increased the leverage, as a result of increase of their debts in report to the equity. Having a look on other items of the balance sheet, outstanding bills, chattel items and fixed assets, the increase can be noticed only on the item of the fixed assets. Therefore, based on this information, one can freely conclude that enterprises in this period increased their assets, particularly the fixed assets; more than sales or profits have increase.

However, none of the ratios on the table shows signs of major deterioration in the balance sheet of enterprises. Even though some of the ratios, such as P& L ratios and debt equity ratios had negative tendency, none of them is at critical level. Drop on sales can be explained rather as a spontaneous phenomenon, caused because of increased competition than any reflection of the financial crisis. Whereas debt to equity ratio of 25% is far below any critical level or enterprises have a lot of space to increase their leverage, without risking of becoming over indebted.

3.4 Balance sheet analysis based on calculated financial ratios

Table 15 is a reflection of the result got from the second method of collecting data. As already has been explained before, some important ratios were used in order to analyze the development of financial statements - balance sheet and profit/ loss statements. In most of the cases, the ratios are calculated, as a share percentage of different balance sheet and P&L items in relation to total assets.

Table 14. Summary of Balance Sheet Analysis - Profitability, Leverage, Development of Balance Sheet Items, Turnover of Inventory (%)

Year	Sales/total assets)	Y to Y difference	Profit/tot assets	Y to Y difference	Debt/_ Equity	Y to Y difference	Out bills/ tot assets	Y to Y differenc e	Chattel items/tot assets	Y to Y difference	Fix asset/tot assets	Y to Y difference	Turnover	Y to Y difference
2007	17.96		2.43		15.70		15.69		23.77		55.35		111.80	
2008	15.51	-2.45	1.94	-0.49	21.76	6.06	15.35	-0.34	22.54	-1.23	58.84	3.48	88.87	-22.93
2009	13.56	-1.95	1.49	-0.45	21.65	-0.12	13.07	-2.28	21.64	-0.90	62.62%	3.78	119.39	30.52
2010	13.67	0.11	1.41	-0.08	23.95	2.30	12.57	-0.50	21.28	-0.36	63.66	1.04	105.22	-14.17
2011	12.29	-1.37	1.33	-0.08	24.92	0.97	13.36	0.79	20.70	-0.58	63.85	0.19	95.85	-9.37
		-5.67		**-1.11**		**9.21**		**-2.34**		**-3.07**		**8.49**		**-15.95**

Profit and Loss ratios - the most common ratios, used in this part of our study, for analyzing main items in the P&L statement are **sales / total assets and profit / total assets**. By using these ratios, we wanted to see the development of turnover and profitability of the company in relation to total assets engaged from the company, throughout the period.

As the table shows, both ratios show declining trend, in report to total assets. The decline is more evident on the first ratio that calculates the sales indicator. Thus, for the period of time 2007-2011, this indicator has shown negative dynamic, registering a drop of 5.6 percentage points. The most significant drop is noticed on year 2008, when the ratios lost 2.45 percentage points.

CONCLUSION

The study has shown evidence that abrupt capital inflow in the country, in cases when they are larger than the existing financial sector of the recipient country, creates vulnerabilities to the entire system. Emerging and transition economies are more prone to these capital surges, due to the size of their economies, inadequate economic and monetary policy and other institutional problems that they inherited from the past.

Because of these capital attacks, they risk worsening the capital account, whereas the domestic currency, which usually is fixed to hard currency, is constantly under pressure of appreciation. This is vicious circle with the end result- increase of the current account deficit. This phenomenon exposes countries to economic and financial vulnerabilities, since it is a self-feeding process, hence, in cases of sudden stop of capital inflows the entire system risks to tumble down.

This can happen very easily, particularly in cases of emerging and transition countries, which in general lack politic and economic stability. Therefore, just a spark of instability shown on political or economic sphere of life may push off potential investors and turn capital surges into sudden stop. Sudden stops of capital inflows, in times when these economies needs desperately higher level of capital inflows to finance the current account deficits, immediately results on capital account and currency crisis, which thereafter contaminates entire financial and economic system, not only on national level but also on the regional level.

The study shows also that transition economies, because of the lack of experience of their institutions, fail to control the capital surges in the country and channel down properly the fresh capital in the real sector of the economy. The experience of the CESSE countries, which have been under pressure of capital inflows from banks coming from developed countries of Western Europe during 90 s, illustrates best the problem.

Traditional banks from developed economies of western world, started penetration on the markets of CESEE, after these countries liberalized and opened their economies to the world. Because of aggressive lending practices, driven by profit maximization, they boosted domestic consumption at the detriment of the sound and responsible banking principles. This model pushed economic growth on the short term, since the accelerator for this growth model was domestic consumption fueled from increase of leverage in the private sector. Whereas they missed the long term perspective of the economic growth, based on building sustainable comparative advantages of their national economies.

Because of these deficiencies, countries of CESEE suffered a lot economically, when the last financial crisis hit the region. This has been evidenced also on our comparative analysis of SEE6, which in our study is represented as a subgroup of CESEE. Macroeconomic indicators has shown that; economic recession, worsening of current account balance, depreciation of domestic currency were problems that followed the last financial crisis. This situation has been reflected also on the financial sector, which resulted on credit crunch, worsening of loan portfolio quality, and decrease of the profitability among their financial institutions.

Kosovo as a country in transition, which shares a lot in common with other countries of SEE, had much favorable position in this regards. The reality that Kosovo did not experience capital inflow booms on pre crisis period, turned to be strength for this country, when the effects of the financial crisis spilled over the region.

Based on the comparative analysis of macroeconomic and financial indicators conducted for SEE6, we have concluded that Kosovo is a country that has shown systematic financial and economic stability, regardless of the financial turmoil that prevailed during the last period. Unlike to other countries that were subject of analysis, Kosovo did not indicate any signs of deterioration of it s fundamental financial indicators. Whereas this situation was different in other countries, in which cases, the financial crisis has hit their financial and economic sectors.

The conclusion about the soundness of the Kosovo's economic and financial sector has been supported also on results gathered from the research, conducted on micro level. The balance sheet analysis of the small and medium enterprises has verified this conclusion.

In addition to this Kosovo, had also endogenous advantages that originated from the existing macroeconomic and financial system. Proper control of financial institutions applied from local authorities, simplicity and transparency of the financial system, strong deposit base as a source for financing lending activities, low competition among banks, low participation of household loans to total private loan portfolio, insignificant investments of banks at international financial markets and Eurozation as an exchange rate regime, are considered to be main advantages that originated from the inside system and saved Kosovo from possible effects of the last financial crisis.

Despite all it s distinct characteristics, which resulted to be it s main strengths in times when financial crisis hit the region , the economy of Kosovo continues to face many fundamental deficiencies. Its economy is considered to be one of the smallest and poorest in the region, whereas existing growth rate, even though among highest in Europe in relative terms, does not provide enough surplus in order to drag out the country from existing poverty and reduce the high level of unemployment. Political stability, lack of clear strategy from local authorities for directing economic growth and development of sound state institutions that work under principles of rule of law, are considered main obstacles for turning the situation towards right direction.

However, in regards to our main topic of the study, Kosovo proved to be a country that avoided the impact of the last financial crisis, situation that is different to other countries in the region. Perhaps its size and insignificancy in relation to the global economy turned to be main strength during the last financial crisis. In other words, the principles Darwin's evolution theory "*not the strongest survive, but the fittest*", has found a solid ground in the case of Kosovo!

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APPENDICES

LIST OF APPENDICES

Appendix A: Calculation of Variation of Countries from the Median of the Group, for Selected set of Indicators

Deposit Growth			
	Country	Country s average 2007 -2011	
1	Montenegro	19.83%	3
2	Kosovo	17.65%	2
3	Macedonia	14.20%	1
	Median	**13.92%**	0
4	Serbia	13.65%	-1
5	Albania	8.44%	-2
6	BIH	8.36%	-3

Loan Portfolio Growth			
	Country	country s average 2007-2011	
1	Kosovo	21.25%	3
2	Albania	20.60%	2
3	Serbia	20.28%	1
	Median	**20.60%**	0
4	Macedonia	18.46%	-1
5	BIH	11.50%	-2
6	Montenegro	0.67%	-3

NPL			
	Country	country s simple difference 2007-2011 on points	
1	Macedonia	13.06%	3
2	Kosovo	2.60%	2
3	Serbia	3.04%	1
	Median	**7.70%**	0
4	BIH	0.00%	-1
5	Albania	0.00%	-2
6	Montenegr	5.52%	-3

ROE			
	Country	difference 2007-2011 , calculated	
1	Serbia	-17.00%	3
2	Kosovo	-50.00%	2
3	BIH	-59.00%	1
	median	**-73.50%**	0
4	Albania	-88.00%	-1
5	Macedonia	-91.00%	-2
6	Montenegro	-483.00%	-3

GDP Growth			
	Country	Difference 2007-20099	
1	Kosovo	-1.00	3
2	Albania	-2.70	2
3	Macedonia	-3.10	1
	Median	**-3.25**	0
4	Serbia	5.00	-1
5	BIH	-4.80	-2
6	Montenegro	-7.80	-3

Appendix B. Questioner from the First Method of Collecting Data, Used for Calculating the Indebtedness Index.

Company: X
Sector: X

no.		**Year**	**2007**	**2008**	**2009**	**2010**	**2011**
1		Number of employees					
2		Annual or monthly sales (average)					
3		Annual or monthly net profit (average)					
4		Debt from financial institutions (our and other)					
5		Debt / Liabilities toward supplier (generated from activity)					
6	Total debt						
7		Euqity					
8		Receivables from clients (generated from core activity)					
9		Monthly installments in our bank					
10		Monthly installments in other banks					
11	Total monthly installments						
13		Frequency of being financed from banks[1]					

1 How many times, on yearly bases, the company has been financed from banks

Appendix C: List of Abbreviations

BIH..Bosnia and Herzegovina
CESEE...................................Central East and South East Europe
CR5..Concentration / Market Share of Five Largest Banks
EU..European Union
FDI...Foreign Direct Investments
GDP.......................................Gross Domestic Product
NPL..Non Performing Loans
P&L..Profit and Loss Statement
ROE..Return On Equity
SEE.. South East Europe
SEE6.......................................SEE (Albania, BIH, Kosovo, Macedonia, Montenegro, Serbia)