

RESEARCH ARTICLE

Financial Crisis and its Reflection in Business Financing: Evidence from Kosovo

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Abstract

The global financial crisis has a negative impact and it's reflected with a decline of economic development in the world. Its effects were also reflected in the countries of euro zone and economy of Kosovo, in spite of allegations that its effects may only be sporadic. Bank system in Kosovo, which provide only standardized products, has avoided the effect of crisis. This was done based on conservatory policy led by commercial banks operating in the country. Such policy caused the restriction of loans for Small and Medium Enterprises (SMEs), those which have more difficulties to receive the loans. So, this causes the declining of investment, turnover, profits and reinvestment. Thus, a general finding is that the financial crisis after all had a negative impact on the real sector of Kosovo economy and its effects will be present also in the future, especially in terms of financing the SMEs.

Keywords: *Financial Crisis, Kosovo, SMEs, World Output.*

Introduction

In open market economies, based on the globalization, the finance of one country is closely related to the international economic and political developments. Since the appearance of crisis in one country has a chain effect on other countries, it also negatively reflected in the countries of SEE, but with different nuances. Globalization, financial engineering and sophisticated of financial products resulted in the crisis expanding throughout the world with serious consequences since august 2007, continuing in 2008 and especially in 2009, where the global economy experienced the deepest economic recession since the Great Depression (1929-33). Based on data from International Monetary Fund (IMF), in 2009 [1], the global economy in general had an economic decline of 0, 6 percent, though the projection has been gloomier, up to 2 percent.

In fact, everything began in Wall Street, where the mortgage market experienced a real fiasco. The banks, initially in USA and then in other countries, applied the system of risk loans, known as "sub-prime", based on which they issued securities, and sold them to other banks, financial institutions, insurance companies, investment funds, through packing in complex financial arrangements. This way, many of the big banks in USA, Europe, Asia, invested in these financial instruments, which in fact were classified as first

class (AAA), it means the highest rating financial instruments. But, the practice proved that such rating was speculative. In this way was dispersed the risk of financial derivatives of American banks throughout the world with an amazing speed through "domino effect". The expansion of sub-prime loans looked like a *giant balloon*, which the more was inflated the risk for it to blow, was increasingly greater.

This was happened now and the consequences to the world economy were and are stunning. As a result, the most developed countries suffered great losses, because of the approach to the financial markets and sophisticated financial products, which also generated the crisis, resulting in economic decline of negative 3.2 percent. Likewise, USA, Euro zone, European Union, Japan and other developed countries experienced an economic decline in 2009 [2]. For 2010, the prognosis of IMF was somewhat better for developed countries in general, USA and developing and transitioning countries, but not also for the countries of Euro zone [3].

For a long time in the economic theory reigned the theory of free market rules, with the conviction that the market has regenerating abilities and it is a regulator of all economic problems [4]. This was the main reason why the intervention of state, government and central banks of different

countries was not immediate. Only when the crisis negatively reflected to the real sector, the Governments and Central Banks almost in all countries, noticing the gravity of situation, took certain measures in order to prevent or remedy the negative effects of the crisis. When it was obvious that the market itself, at least in short terms, can not recuperate the situation, the following measures were taken:

- Reduction of key interest rate in order to increase the liquidity in the financial sector.
- Increase of state deposit insurance guarantees.
- Intervention with public funds for recapitalization of banks.

Such measures gave results in the stabilization of banking sector and positively reflected the real sector. As a result, in the last quarter of 2009 it was officially announced that the countries of euro zone went out of the recession, recording an economic growth of 0.4 percent. But still were negative economic growth [5].

Table 1: World economic outlook projections (2008-2011)

	2008	2009	2010	2011
World output	3.0	-0.6	4.2	4.3
Advanced economies	0.5	-3.2	2.3	2.4
USA	0.4	-2.4	3.1	2.6
Euro Area	0.6	-4.1	-1.0	1.5
European Union	0.9	-4.1	1.0	1.8
Japan	-1.2	-5.2	1.9	2.0
United Kingdom	0.5	-4.9	1.3	2.5
Emerging and Developing Economies	6.1	2.4	6.3	6.5
Central and East Europe	3.0	-3.7	2.8	3.4
China	9.6	8.7	10.0	9.9
India	7.3	5.7	8.8	8.4

Source: IMF /World Economic Outlook : Rebalancing Growth, 2010.

However, in spite of the measures taken by central banks to increase the liquidity in market, credit growth remains low. This will have negative impact on investments and declining of economic activity in general [6]. While economy recorded positive trends, unemployment rate in the countries of euro zone continues to increase. By the end of 2009 the unemployment rate in euro zone reached 9.6 percent, the highest rate recorded in the last decade (CBK, 2010). The negative effects of the crisis didn't spare the economies of Central and East Europe either, since their economic output in 2009 resulted with negative 3.7 percent. By all countries in this zone, only Kosovo and Albania reported economic growth for year 2009. The crisis also conditioned the banks in this region to lead a more conservative lending policy, which cause a low

level of lending activity. Certain countries recorded negative credit growth rates.

Table 2: Growth rate of deposits and loans in SEE (2009)

Countries	Loans	Deposits
Albania	12.1	58
Bosnia and Herzegovina	-1.4	-7.6
Macedonia	14.5	-0.3
Montenegro	-9.9	-18.3
Kosovo	13.2	17.3
Croatia	-0.5	-0.3
Serbia	20.3	16.5

Source: IMF /World Economic Outlook : Rebalancing Growth, 2010.

Based on these data, some countries of SEE recorded a negative growth rate of loans (Montenegro -9.9 percent, Bosnia & Herzegovina -1.4 percent and Croatia -0.5 percent) and deposits (Montenegro -18.3 percent, Bosnia & Herzegovina -7.6 percent and Croatia -0.3 percent). This conditioned the restriction of loaning policies, which were followed with an increased conservatism, which further resulted in stagnation and declining of lending growth, especially for businesses. Consequently, the enterprises (small and medium) face difficulties to reach needed financial potential, which results in various negative effects: decline of investments, turnover, declining their credit ability, which results in difficulties in repayment, those worse the loan portfolio in banks.

The Impact of Financial Crisis in Kosovo

The global financial crisis also pervaded Kosovo, and greatly affected its financial and economic system, in spite of voices that the effects of crisis can only be sporadic. The negative reflection of crisis, caused a low level rate of economic growth, which in 2009 was projected to be 3.8 percent, compared with the growth rate of 5.4 percent in 2008 (IMF, 2009). The crisis directly affected the reduction of consumption and investments in private sector, declining of remittances, declining of level of lending either because of more conservative lending policies applied by banks, reduction of exports, or because of the declining of foreign direct investments. This way the crisis affected the financial system which is mainly dominated by commercial banks, the assets of which in 2009 represented around 78.4 percent of total assets. The other part of sector consists of pension funds (around 13.3 percent), micro-financial institutions (5.1 percent), insurance companies (3.0 percent) and financial supports (0.1 percent).

Initially, the first impact was noticed in the Kosovo Pension and Savings Trust (KPST) since

most of its financial assets were invested in foreign financial markets [7]. As a result the value of shares invested in foreign markets by the end of 2008, declined over 30 percent, or around 100 million Euros, which is around 10 percent of the Kosovo Consolidated Budget (KCB). This value for the circumstances in Kosovo is a very great blow. The practice proves that such financial assets would be safer if they were invested or deposited in the Kosovo market. This is supported by the fact that the Board of Trust took the decision starting from the beginning of 2010 to deposit the amount of 10 million Euros to commercial banks in Kosovo, with much more profitable interest rate than in foreign market. Furthermore the crisis affected the real economy sector. If we analyze the Payment Balance of Kosovo, it is obvious that the negative effects of the crisis, which reflect a very high rate of imports, cause a considerable deficit in the current accounts (around 16 percent of GDP).

Based on table 3, the account in 2009, was characterized with a deficit of 277.8 million euros, which is a result of great economic dependence on imported goods with 91.3 percent of total goods trade, compared with 6.9 percent of exports. The first half of 2009 is characterized with a slight decrease of exports to 62.7 million euro [5]. The nominal rate of the export decline in Kosovo was 39.9 percent (respectively, the real rate of export decline for 37.5 percent as a result of current deflation in the economy of Kosovo).

Table 3: Trade of goods (000.000 Euros, cumulative within calendar year)

Year	2006	2007	2008	2009
Exports	48.3	74.9	104.4	62.7
Imports	-554.6	-697.0	-854.9	-840.8
Trade balance	-506.3	-622.1	-750.5	-778.1
Exports/Imports (%)	8.7	10.7	12.2	7.4

Source: CBK, Payment Balance Bulletin, Prishtina, 2010.

Since after the war, in terms of imports, until the year 2009, for the first time there was an annual declining for 1.6 percent in nominal value. Even though this decline at first sight is small, in fact it had an impact on the stagnation of economic activity and decline of internal demand. It also resulted in the declining of business activities in the country. There was also a declining of export activities in 2009, where the coverage of imports with export was only 7.4 percent. Initially the declining of exports was a result of considerable declining of demand, and declining the prices of basic metals in bourse. Compared with the same period in the previous year where basic metals covered approximately 2/3 of the total export, or 64.8 percent, in 2009 they covered slightly more

than 1/3 or 42.2 percent. As a result, the businesses that were directly negatively affected in the field of export were: "Trepça-mine complex"; LLC "FERONIKEL" and SMEs which deal with the sale of second hand metals. In addition, the business that deal with the export of food products (beverages, natural fruits, mushrooms), the participation of which was only 5.6 percent of the total exports in 2008, recorded a considerable declining of 26.4 percent in 2009 [6]. As a result of the crisis the *remittances* were greatly affected and recorded a considerable decline. According to the official data of CBK, the transfers of private sector, which mainly consist of remittances from emigrants, reached the amount of 222.3 million euros by in 2009, which compared with the previous period in 2008 recorded a decline of 11 percent. Just to clarify, the level of remittances in 2008 constituted 14 percent of GDP, whereas in 2009 only 8.4 percent, which records a drastic decline. This decline in fact close corresponds with the decline of remittances in the countries of the region and it came as a result of reflection of financial crisis in the countries of euro zone, where Kosovo emigrants are mostly concentrated. This in fact has a negative impact on the overall economic activity in Kosovo, since a great part of consumption is financed precisely from remittances [8].

The banking sector in Kosovo, which constitutes the main pillar of financial system in the country and is still underdeveloped, greatly shirked the impact of the financial crisis. This is because of low investment in more sophisticated financial products, and low exposure to high risk instruments. Thus, in spite of negative international financial and banking developments resulting from the financial crisis, it preserved the high level of stability of business consistency.

Despite its continuous advancement, the function of commercial banks continues to be basic, mainly concentrated on the lending of domestic economy, getting financed from the deposits accumulated within the country. This made the commercial banks operating in Kosovo to have a low exposure to the foreign sector, whereas financing from deposits accumulated within the country made the rate of loans in Kosovo not to depend on supply, and cost of funds in the foreign sector. Whereas, only a part of financial assets were deposited in foreign correspondent banks and only for their needs to perform daily banking transactions, and there were no investments in financial derivative instruments, which were affected by crisis [9].

Table 4: Structure of assets (%)

Year	2006	2007	2008	2009
Cash and Balances with CBK	12.	13.2	11.1	14.4
Balance with commercial banks	20.9	14.05	17.2	16.9
Securities	8.5	5.5	2.4	1.0
Lending and leasing	54.9	62.2	64.4	61.9
Fixed assets	2.0	1.9	2.0	1.9
Other assets	1.6	2.8	2.7	3.9

Source: CBK, Payment Balance Bulletin, Prishtina 2010.

If we look at the structure of assets of banking sector, during the period of global financial crisis there are no major differenced compared with the previous years. The main part in the asset structure, the lending item, constitutes the biggest share of almost 62 percent in 2009, which compared with the previous period decreased by 2 percent, respectively 0.3 percent in 2007. The position with biggest changes is Securities, which in the structure of assets constitute only 1percent in 2009, whereas in 2008 it constituted 2.4 percent, respectively 5.5 percent in 2007. The decrease of investments in securities, increasingly started at the beginning of 2008 as a result of transfer of investments to domestic economy lending, which provide a higher rate of return, whereas their decline in the last period is

attributed to the negative developments in the international financial markets. A slight decline 0.2 percent is noted also in the share of placements in commercial banks abroad, accounting for 16.9 percent of total assets in 2009.

The structure of assets in banking sector of Kosovo shows an exposure to the external sector equivalent to 11 percent of GDP. The structure of banking sector assets invested abroad is mostly comprised of deposits at commercial banks and a slight share of investments in securities. Whereas the major part of banking sector assets or 89 percent of total assets is exposed to the economy of Kosovo.(CBK, 2010). As a result, the banking sector in Kosovo was mostly protected and the financial crisis had sporadic effects in it. This way the deposits but also lending had an increase in 2009 even though this increase was slow [10].

However, if we analyze the deposit and lending potential of commercial banks operating in Kosovo, separately, we notice a variety related to the level of deposit collection and the use of that potential in terms of business lending. The increase of deposit potential is not always followed with the same level of lending to economy, especially in SME sector. This can be best observed as follow:

**Fig. 1: Increase of deposits and lending in Kosovo**

Source: CBK, Balance of Commercial Banks, Prishtina 2010.

Table 5: Deposits in 2008-2009

Bank	2008	2009	(%)	2008	2009	(%)
Pro Credit Bank (PCB)	564,377	627,426	11	424,215	450,923	6
Raiffeisen Bank (RBKO)	493,037	543,733	10	407,406	345,201	(15)
NLB- Prishtina	192,049	249,118	30	137,334	162,982	9
Economic Bank (BE)	72,599	84,535	16	53,033	62,409	20
Bank for Business (BpB)	51,705	76,636	48	33,615	47,673	42
National Trading Bank (BKT)	8,242	40,623	393	9,541	37,545	294
Turk Economic Bankassi (TEB)	40,386	105,737	161	36,455	76,616	110
Total	1,422,395	1,727,808	121	1,101,599	1,184,349	107,5

Source: CBK, Balance of Payments Bulletin, Prishtina 2010

According to the above data, despite the effect of the crisis and possibility of lack of trust in banks, compared with the circulation of deposits in the biggest banks in the world and in SEE, the deposits in the commercial banks in Kosovo have a growing trend, even though the rhythm is not the same. The biggest growth rate of deposits in percentage had BKT, approximately four times more than in 2008. However, it should be mentioned that BKT was in the initial phase and had a more aggressive policy of deposit collection, increasing the passive interest rate. Naturally, this had its cost in its financial result. Whereas, in terms of absolute value the biggest growth rate was recorded by RHZ, with absolute amount of 63,049,000.00 euro. However, if we analyze the volume of loans, most of the banks have a growth rate of lending to economy with the exemption of RBKO which has a decline of 15 percent, but this growth is smaller compared with the increase of deposit, starting from 5 percent, up to 100 percent.

If we observe the average of banking industry, in 2009 deposit in the commercial banks in Kosovo increased for 21 percent compared to previous year, whereas loans have a negative growth for 7.5 percent compared with previous year. This means that the difference between the increase of deposits as basis for lending to economy, and loans issued by the banks differ approximately 13.5 percent. This result in slowness of the lending for economy needs. This slowness in lending by banks happened as prevention since they lead a more conservative policy of issuing loans than in the past, which resulted in the declining of loan portfolio, in particular for SME loans, which now have more difficulties to get the loans. This had a direct negative impact also on the financing of needs for working capital and needs for additional investments [11].

Table 6: SME and household loans

Year	2008	2009
SME loans	72.8	74.2
Household loans	23.2	25.8

Source: CBK, Annual Report, 2010

The annual growth rate of loans in 2009 was only 4.6 percent compared with the previous year when it was 30.5 percent, whereas, in household economies there was an increase for 22.3 percent compared with previous year [12]. However, the structure of granted loans by the commercial

banks is dominated by loans for enterprises (micro, small and medium).

Table 7: SME loans by sectors

SME loans	2008	2009
Services	76.4	72.2
Industry, energy, construction	19.4	23.0
Agriculture	4.1	4.2
Mines	0.1	0.6
Total	100	100

Source: CBK, Monthly Statistic Bulletin, 2010

If we look at the structure of enterprise loans according to the sectors, we will notice that that loans for service SME dominate with 72.2 percent compare with 76.4 percent in 2008. The business loans for industry, energy and construction cover with 23.0 percent in 2009 compared with 19.4 percent in 2008. The agriculture lending is approximately the same in two years, still low. The lowest sector which commercial banks have issued the loans, yearly, is the mines sector, against the fact that in 2009 the lending portfolio increase six time compare with 2008, but still is only 0.6 percent, compare with other sectors.

Conclusion

The global financial crisis that shook the world, in spite of voices that its effects in Kosovo would be minor, it again had a negative impact on its economy. The first wave of negative effects affected Saving and Pension Trust, whose assets were invested in international financial markets. This negative impact also reflected on remittances since the largest number of emigrants from Kosovo, are in the countries which were mostly affected by the crisis. The export of Kosovo, although low, was greatly damaged by the export of basic metals the price of which is quoted in international stock markets. As a result of decline of demand their prices fell too.

Despite the fact that the banking system does not have symptoms of being directly affected by financial crisis, the commercial banks were more reserved and led a more conservative loan policy, especially when providing loans to different enterprises (small and medium). This resulted in the decline of investments, overall turnover, profits, and recapitalization of SME. Therefore, as a result their loan ability has decreased. This in fact caused the reduction of the ability to return their debts to banks, as a result of which the percentage of non-performing loans in banks marks a growing trend. This can cause a series of negative consequences for Kosovo enterprises that exercise certain business activities, but also for the banking system in general in Kosovo.

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