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## **DEVELOPMENT OF BANKING SECTORS IN KOSOVO AND MONTENEGRO IN THE YEARS 2000-2010**

**JEL Classification:** G21

**Keywords:** *banking sectors, Kosovo, Montenegro, Balkan countries*

**Abstract:** *The article presents main aspects of the development of banking markets in two Balkan countries – Kosovo and Montenegro. Both of them are characterised by similar recent history, both in political and economical fields. Their financial sectors had to be built almost from scratch. The author describes the stages of development of competition in the banking sectors, using the following ratios: performance, structure, liquidity. The data is based on the information achieved from Kosovar and Montenegrin central banks. Comparison of their achievements are presented on the pentagon adopted from macroeconomy stability pentagon, introduced in Poland by Institute for Market, Consumption and Business Cycles Research. The long way from centrally planned economy to market economy, in both countries, in both political and financial aspects has resulted in a successful transformation. The growing economic strength in Kosovo and Mon-*

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*tenegro will allow their financial institutions to improve their performance and expand their activities in the future.*

## INTRODUCTION

The two countries – Kosovo and Montenegro – have quite a similar modern history and experiences concerning the struggle for independence, but do they develop likewise in the field of economy, especially financial markets? Both of them decided for unilateral europeanisation which seems to be a reasonable step into development of their economies, since they did not have their own currency earlier.

The aim of the article is to describe the development of the banking sectors in two former Yugoslavian republics: Kosovo and Montenegro which have formed their own banking system in the last decade. The article presents the differences in the current situation in this sector of economy. The following research methods were used to gather the qualitative and quantitative data: document review, literature review and international study. The author collected various documents, reports, financial statements covering the performance and structure of the banking sectors in the analyzed countries. The review of literature is based on materials which are publicly available and include academic journals, books, conference presentations, news media articles and web sites. The international study examined the international literature with attention paid to international comparative studies and on adopting the macroeconomic stability pentagon, introduced in Poland by Institute for Market, Consumption and Business Cycles Research for the purpose of banking sectors' comparison.

## HISTORY OF KOSOVO AND MONTENEGRO

For many years the Socialist Federal Republic of Yugoslavia used to be a federal republic, consisting of the following provinces: the Socialist Republic of Bosnia and Herzegovina, the Socialist Republic of Croatia, the Socialist Republic of Macedonia, the Socialist Republic of Montenegro, the Socialist Republic of Serbia and the Socialist Republic of Slovenia. The country had always been a home to a very diverse population, both in terms of national and religious affiliations. The two biggest national groups were the Serbs and the Croats respectively accounting for almost 40% in 1971 (over 36% in 1981) and over 22% (almost 20% in 1981). The other 28% in 1971 (30% in 1981) included 4 groups: the Muslims, the Slovenians, the Albanians and the Macedonians. And last but not least, the group with the



share of over 1% were the Montenegrans. Religious differences among Orthodox Christian Serbs, Catholic Croats, and Muslim Bosnians and the rise of nationalism contributed to the collapse of Yugoslavia in 1991.

But before the 1990s, Yugoslavia had solved the national issue of nations and nationalities (national minorities) in a relatively easy way that all nations and nationalities had the same rights. Between 1945 and 1980 the country was governed by Marshal Josip Broz Tito. Thanks to his strong political leadership, the country distanced itself from the USRR in 1948 and could expect support from the western countries. Tito used the estrangement from the USSR to attain US aid via the Marshall Plan, as well as to involve Yugoslavia in the Non-Aligned Movement, in which he assured a leading position for his state. Yugoslavia, which was constructed by the communists as a formally federal country, actually was ruled by Tito in a dictatorial way but stayed outside the Soviet bloc. The charismatic leader with a hard line on government maintained peace in the country.

In the 80's inter-ethnic tensions grew and developed into open war conflicts, as a result of which the former Republics declared later their independence: Croatia, Slovenia and Macedonia (1991), Bosnia and Herzegovina (1992), Montenegro (2006), Kosovo (2008). After sanguinary conflicts the countries had to be rebuilt and needed to heal their economies, including all institutions like these which are responsible for financial markets.

## **ECONOMIC BACKGROUND OF KOSOVO AND MONTENEGRO**

As a result of ethnics conflicts of the 1990s Montenegro became a part of Serbia. On 21<sup>st</sup> May 2006, in referendum the citizens of Montenegro decided about their independence from the union with Serbia. With only 2,300 votes the 55% threshold was passed, necessary to validate the results of voting under the rules set by the European Union. Montenegro's independence has been recognized by Serbia, the member-states of the European Union, and the permanent members of the United Nations Security Council.

In the case of Kosovo, there was no referendum during which citizens could declare their country's independence. But before this declaration the republic enjoyed relative autonomy from Serbia Republic. The independence was approved by the Assembly of Kosovo on the 17<sup>th</sup> February 2008. Although some states protested, e.g. Russia, numerous states announced their recognition of this declaration. Currently 69 United Nation states recognize the independence of Kosovo and it has become a member country of the IMF and World Bank as the Republic of Kosovo.



The Republic of Kosovo is a country with 2 million inhabitants focused on running economic policy aimed at a free trade system. Over the course of the 1990s the economy of Kosovo was seriously damaged because of some reasons, among which the most serious were a blend of poor economic policies, international sanctions and poor external commerce. Moreover, the Kosovar economy was severely hit by the war in 1999 when Kosovo's estimated GDP was 1–1.5 billion USD and the unemployment rate hovered around 74 percent. (*Technical Assistance to Support...* 2008). After the conflict there were no own banks operating in Kosovo. Therefore, there was a need to draft a legal framework which ensured the fulfillment of European standards of competitiveness. It introduced two tier banking system consisting of Central Banking Authority of Kosovo and commercial financial institutions. With the acceptance of 95% of citizens measured in a referendum, on 26<sup>th</sup> June 2009 Kosovo joined the International Monetary Fund and the World Bank becoming the 186<sup>th</sup> member of this organization.

Both countries replaced Yugoslav dinar with the German mark in 1999. In consequence of switching Germany for euro in 2002, they had to adopt a new currency as well. In this way these countries became examples of these few which decided for unilateral europeanisation without fulfilling cohesion conditions. The decision can be recognized as a success, because their economies are relatively small but open, have experienced hyperinflation and obtained relatively low seniorage income and have got high foreign reserves.

With the use of the stable currency as an official means of payment, the prerequisites for the development of an efficient financial sector and stable macroeconomic environment were in place. Benefits arising from the introduction of the euro in Kosovo and Montenegro have been obvious and resulted in decrease of inflation rates and strict financial discipline. In particular, the euro has given both countries a considerable advantage over its competitors in the region by making it more attractive to foreign investment, due to low transaction costs as well as the elimination of exchange rate and currency risk (*Investing in Kosovo...* 2010).

The degree of openness of an economy can be presented by the value or volume of foreign trade. Kosovo is still an import-based economy. Since 2004, the value of import has been increasing y/y steadily but faster and faster, from the rate at the level of 8% in 2004/2003 to almost 26% in 2008/2007, which means an increase of import from the amount of less than 1,000 million euro in 2003 to about 1,900 million euro in 2008. Simultaneously, export increased fivefold reaching more than 190 million euro in 2008, while the rate of exchange y/y was very uneven.<sup>1</sup> The economy of

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<sup>1</sup> Data based on Statistical Office in Kosovo and Central Bank of Kosovo.

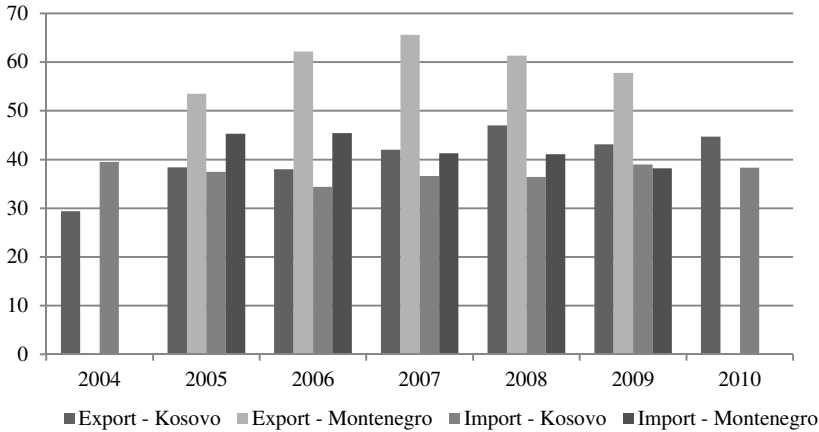


Montenegro is mostly service-based and is in late transition to a market economy. The country entered recession in 2008 as a part of the global recession, with GDP contracting by 4%. However, Montenegro remained a target for foreign investment, the only country in the Balkans to increase its amount of direct foreign investment. (Zuvela 2009). However, the significant dependence of the Montenegrin economy on foreign direct investment leaves it susceptible to external shocks and a high foreign trade deficit. According to data gathered by *World Bank* (2009), in 2007, the service sector made up for 72.4% of GDP, with industry and agriculture making up the rest at 17.6% and 10%, respectively. It must be stressed that the share of trade, both in export and in import, with EU members has been rising, reaching the level of 47% of export from Kosovo (2008) and almost 90% in case of Montenegro's export to EU (2010). In the report *Investing Across Borders 2010*, prepared by the World Bank (2010), both countries are recognized as examples of the most open economies to foreign equity ownership in Eastern Europe and Central Asia. In Montenegro there are no legal ownership restrictions on the 33 sectors covered by the World Bank report's indicators, and in Kosovo launched the Law on Foreign Investments grants foreign and domestic investors equal rights to ownership of local companies, following the principle of national treatment. With the exception of railway freight transportation, all other sectors in Kosovo measured by the report's indicators are fully open to foreign equity ownership. Moreover further processes of structural reforms and of privatization are ongoing.

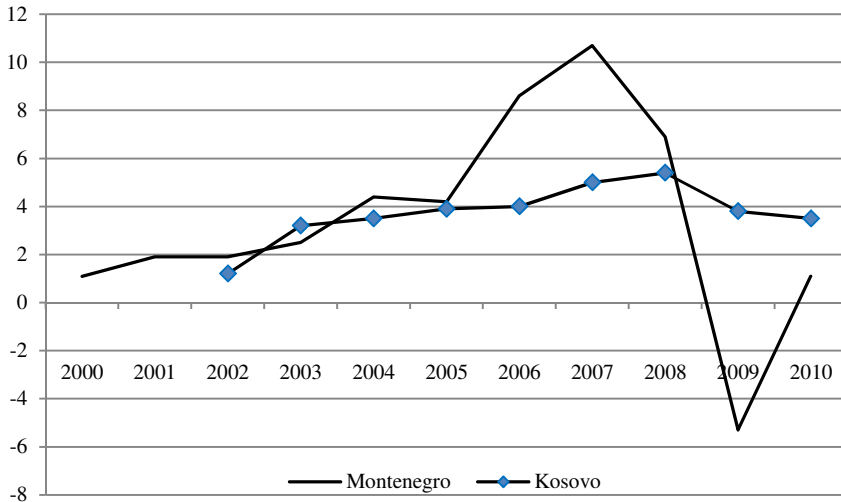
Figure 1 presents the share of EU members in foreign trade of both countries in the period between 2004 and 2010.

The favorable changes in GDP and inflation, presented on figures 2 and 3, are recognized as advantages which supported the process of unilateral europeanization. In Kosovo GDP rose from 2% in 2002 to almost 6% in 2008. Montenegro experienced the growth of GDP between 2002 and 2007 reaching the level of over 10% in 2007 but the following year was the first of the fall to about 7%. According to the IMF (2009), the nominal GDP of Montenegro was 4.822 billion USD in 2008. GDP grew at an impressive pace of 10.7% in 2007 and 7.5% in 2008. According to Eurostat data (2009), the Montenegrin GDP per capita stood at 46% of the EU average in 2008.



**Figure 1. Share of EU members in foreign trade (as % of total)**

Source: author's calculations based on Kosovo under UNSCR 1244/99 Progress Report, SEC(2009) 1340/3, European Commission, Brussels 2009 and Montenegro 2009 Progress Report, SEC(2009) 1336/2, European Commission, Brussels 2009, MONTENEGRO 2009 PROGRESS REPORT, SEC(2009) 1336/2.

**Figure 2. Increase of GDP between 2002- 2010 (change in % y/y)**

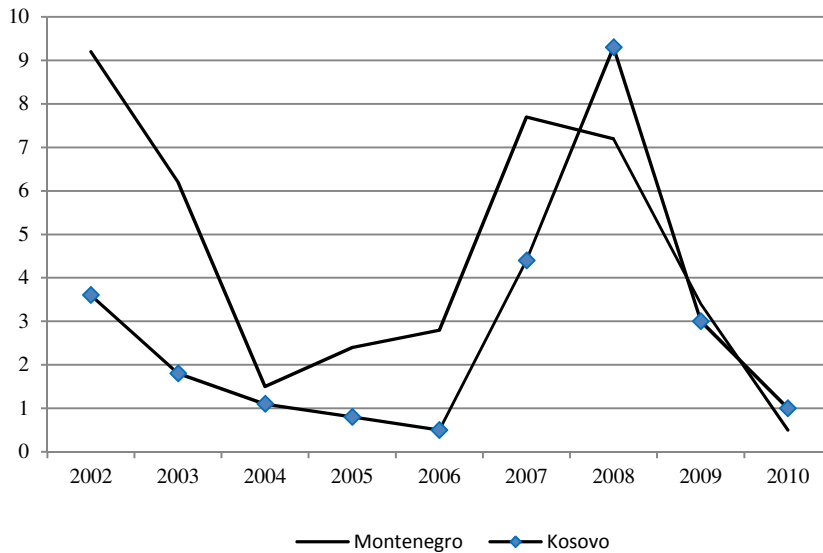
Source: author's calculations based on data from Central Banks of Kosovo and Montenegro (2000-2009).



The year 2009 turned out to be the first when Montenegro experienced dramatic drop of GDP growth. As a consequence of global crisis, Montenegrin GDP decreased by  $-5.3\%$  in 2009/2008. The country was expected to exit the recession in mid-2010, with GDP growth predicted at around  $0.5\%$ . (Tanner 2009), which was achieved, and at the end of 2010, when GDP growth reached level of  $1.1\%$  y/y. In Kosovo, the situation was not so destructive. Although the economy observed slowdown the change of GDP growth was relatively slight. In 2009-2010 the Kosovar GDP rose by  $3.5-4\%$  y/y, which was similar to the level dated 2005-2006.

The inflation rate has been changing very similarly in both countries: in the first year there was a strong fall, then three years of relatively stable situation, which were followed by the increase of  $7-9.5\%$  in 2008 and further in 2010 a drop to  $0.5-1\%$ , what is presented in figure 3.

**Figure 3. Inflation rate between 2002- 2010 (change in % y/y)**



Source: author's calculations based on data from Central Banks of Kosovo and Montenegro (2002-2009).

## STRUCTURE OF BANKING SECTORS

According to J.P. Bonin (2004), generally former centrally planned economies can be characterized by a noticeable structural segmentation (i.e. large specialty banks monopolizing specific market segment), state ownership of a significant proportion of banking assets and high concentration ratios. Conversely, banking system in former Yugoslav Republics (including Montenegro) used to be a two-tier banking system, with universal banks operating in particular Republics. Furthermore, since the 1950s banks were not state-owned, as they were owned collectively according to the principles of Yugoslav self-management (Kořak, Ćok 2008).

But despite this advantage, the common feature of the banking systems in Kosovo and Montenegro was their low development the roots of which should be traced in the pre-transition political and economic situation. Since the beginning of transition in the early 1990s, the banking sectors have undergone radical changes. However, the starting positions in the individual case were quite diverse.

Financial markets in Kosovo had to be built from scratch, on completely new foundations. This process included establishing in November 1999 the Banking and Payments Authority of Kosovo (BPK), which was an entity regulating successfully the banking and insurance sectors. In 2000 in Kosovo there was only one bank (with 5 branches) operating. The rapid jump in the number of branches and employees prove that the banking sector grew strongly within 2001-2004. The number of branches climbed to 207 in 2004 and the number of bank employees grew from 139 to 2066 resulting in significantly higher rate of market penetration for banking services. (*Banking in Serbia and Montenegro*, 2005) The changes between 2004 and 2010 were not so significant, but very stable. Number of branches rose to the level of 303 in 2010 (287 in 2008), while the number of employees increased to the level of 3,767 in 2010.

Nowadays, the financial sector is bank-based, which is two-tier, consisting of central bank and financial commercial institutions: 8 private banks, 11 insurance companies and two pension schemes, 49 financial auxiliaries and micro-finance institutions. The number of banks has remained at the same level since 2001 due to BPK's restrictive license policy. All of Kosovo's banks are private and 6 of them belong to foreign investors. The quite high foreign share in the banking market capital has been fairly constant since 2001 due to the leading role played by international financial institutions in rebuilding the financial infrastructure. The sector is highly concentrated. Three largest banks, all owned by foreign investors hold almost 80% of market share measured by total assets. The largest bank's market share, amounting to 41.2%, belongs to the Procredit Bank, established at





the initiative of several leading international financial institutions. Raiffeisen Bank of Austria is the second largest bank, taking into consideration its assets share. But with 69.8 million euro this bank owns the largest equity in the sector. Local banks, including the New Bank of Kosovo, the Bank for Private Business, the Economic Bank, the Credit Bank of Pristina and the Kasabank, are licensed by the central bank and offer similar banking services and products.

Unlike Kosovo, Montenegro had the advantage of already existing and operating banking infrastructure. But despite this fact, the system was highly underdeveloped. Between 2000 and 2006 the number of banks was stable as there were 10 of them. In 2007 the number of banks in Montenegro increased by one and has stayed unchanged until today. Till the fall of 2005, there were 7 banks in Montenegro in which foreigners had the majority, which meant a strong increase of foreign participation in the sector from 30% up to 70% taking into consideration only the number of institutions. Between 2005 and 2009 this share advanced to 82% because two new foreign banks were established. As the privatization of state-owned banks was one of the most important elements in the rehabilitation of the banking sector, mainly through entrance of foreign banks, foreign share in capital has notably been growing, contrary to the state-owned one which decreased to zero in 2006.

At the end of 2005, the banking sector in Montenegro had a high level of market concentration at 66% based on the total assets of the three largest banks. The largest Montenegrin bank at the time was Crnogorska Komercijalna Banka, which was 100% privately owned. The concentration for the five largest banks shows the high concentration ratio, reaching 81% of total banking assets.

## **FINANCIAL INTERMEDIATION**

In many emerging economies, low financial intermediation rates provide the basis for the strong growth in future. According to bankers<sup>2</sup>, all South East European (SEE) countries would make use of their catch-up potential, resulting in above-average growth rates for more than ten years. The best evidence, proving this impressive potential, are changes of the following indicators: banking sector assets to GDP, total loans to the non-financial sector to GDP or total deposits from the non-financial sector to GDP.

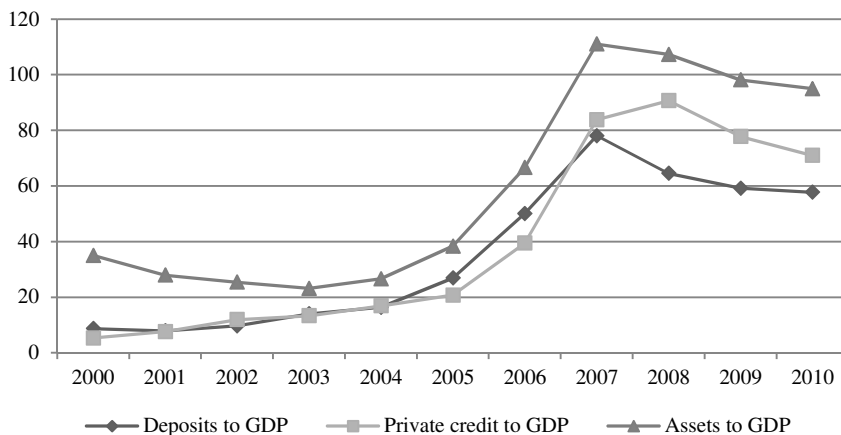
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<sup>2</sup> Gernot Jany, banking sector equity analysts at Erste Bank.



In Montenegro financial intermediation remained low during the first years of building the banking system, mainly due to the weak depositors' confidence. In the course of years the indices of financial intermediation have shown signs of improvement resulting from rising trust in the system, which are presented in figure 4 but they have still been low, which represents a great catching-up potential. The deposit growth plays a crucial role in the funding of SEE banks. "While the deposits are already at a relatively high level in countries like the Czech Republic and Croatia, in the emerging banking markets, a significant amount of money is still stored in under mattresses. Commercial banks ought to continue to replace piggy banks as confidence in the banking market rises" states Gernot Jany.

**Figure 4. Rate of financial intermediation in Montenegro (as % of GDP)**



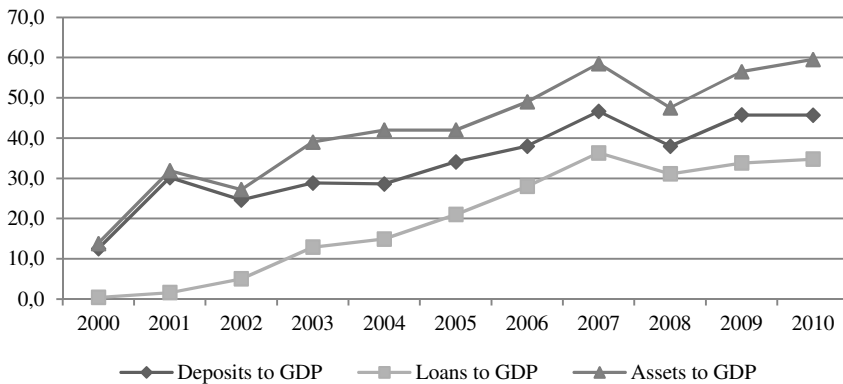
Source: autor's calculations based on data from Central Bank of Montenegro (2000-2010).

In Montenegro between 2003 and 2010, savings increased almost 9 times while credits rose 12 times. The low penetration of loans provided the basis for the strong lending growth rates in the coming years. In December 2004, loans amounted to 281,482 thousand euro, showing a much higher level than in the previous year (200,625 thousand euro) while deposits also measured an increase from 211,008 thousand euro in 2003 to 273,194 thousand euro at the end of 2004. In the course till 2007 trends in the Montenegro financial sector included strong growth both in loans and deposits. The highest leaps (over twice) were noticed in 2006/2005 in case



of deposit and 2007/2006 for loans. At the end of 2009 the loans totaled 2,397,756 thousand euro, which was the first year of fall (by almost 15%) comparing to the previous year. In case of deposits the opposite tendency has been seen since 2008, when it became weaker by 5% in comparison to 2007, from the amount of 2,091,075 thousand euro in 2007 to 1,990,590 thousand euro in 2008. The decrease doubled in 2009, reaching 10%, with deposits falling to the level of 1,824,688 thousand euro. The year 2010 resulted in decreases, both in terms of deposits (by 2% comparing to 2009) and credits (by 8% comparing to 2009). What is worth mentioning is the relatively fast upward trend of non-performing loans during the period between 2000 and 2010, ranging from level of 2% in 2000 to over 17% in 2010.

**Figure 5. Rate of financial intermediation in Kosovo (as % of GDP)**



Source: author's calculations based on data from Central Bank of Kosovo (2000-2010).

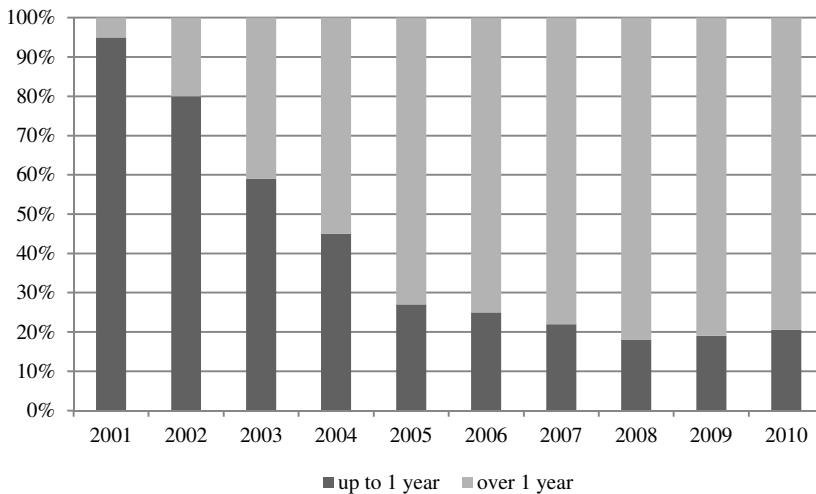
In Kosovo, the banking sector has been growing quickly as well. According to the World Bank, there has been a rapid increase in loans and deposits as a percentage of GDP in the past few years. Intermediation rate measured by asset to GDP advanced even faster than in Montenegro, but only till 2005, when ratios for both countries reached the level of 42% GDP. Later, the growth of intermediation ratios was not as strong as in Montenegro. In terms of lending and depositing activity, the Kosovo banking sector operates relatively well, but comparing to Montenegro its results



are also worse. The loans granted by the banking sector of Kosovo accounted for almost 35% of GDP in 2010 comparing to an average of 71% for Montenegro. The deposit to GDP ratio in Kosovo ranks also lower than the ratio obtained in Montenegro (46% in Kosovo and 58% in Montenegro). The described financial intermediation rates for Kosovo are presented on the figure 5.

Although the achievements of Kosovo's banking sector comparing to Montenegro's banking market is not so considerable, it ought to be stressed that the amount of loans granted each year in Kosovo rocketed between 2002 and 2010 by over 31 times from the level of 47 million euro to 1,46.0 million euro in 2010. Simultaneously, the amount of deposits raised "only" by 3.9 times, from 492 million euro in 2002 to 1,92.0 million euro. What is worth mentioning is the changing structure of loans due to their maturity. Till the mid 2004 more than half of loans were short-term credits (up to 1 year). Since then, the higher and higher participation has belonged to long-term credits and loans (over 1 year), which is shown on the figure 6. The main drivers for their growth are mortgage and consumer loans which are a consequence of decreasing unemployment rates, rising GDP per capita and subsequently growing demand for consumer goods and housing.

**Figure 6. Structure of loans in Kosovo**



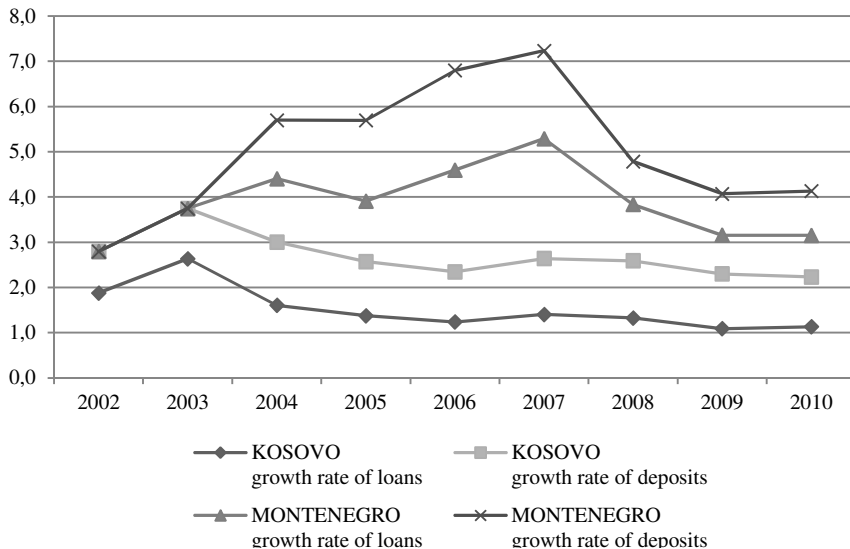
Source: author's calculations based on data from Central Bank of Kosovo (2001–2009).



Although annually both total credits and total deposits in Kosovo have increased in the analyzed period, but with various speed. After a strong annual enhancement of loans between 2002 and 2003, its rate of growth began to lower, but stayed on the level between 23% and 40% y/y. The continuous growth of loans to the economy shows not only improvement in the maturity of Kosovar business environment, but also that commercial banks were gaining more confidence in the domestic market. From 2007, the rate of credit growth has been slowing down, so in 2010 deposits raised much faster: 40.5% for deposits comparing to 6.8% for loans. These trends in granting loans and gathering deposits by each banking sector influence strongly not only the preference but mainly liquidity of the sector.

Considering liquidity position in Montenegro, the situation in this aspect is changeable. Between 2004-2006 and since 2009, the rate of deposit growth has been noticeable higher than loans growth rate. The deposits increasing faster than the growth of loans supported banks' liquidity and created opportunity for further development of sector's activities in area of credits. The comparison of growth rates of deposits and loans for both countries is shown on the figure 7.

**Figure 7. Liquidity of banking sectors in Kosovo and Montenegro (change in % y/y)**

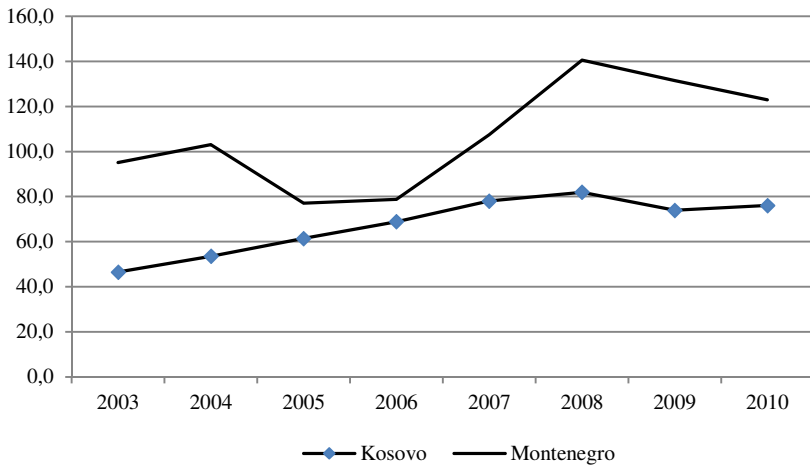


Source: author's calculations based on data from Central Banks of Kosovo and Montenegro (2002-2010).



Another way of presentation the sector's liquidity is comparing amount of loan to deposit, as it is shown on figure 8. The figure reflects the changes observed by comparing respective rates of growth. The faster deposits grow over loans the faster loan to deposit ratio changes.

**Figure 8. Loan to deposit ratio in Kosovo and Montenegro**



Source: author's calculations based on data from Central Banks of Kosovo and Montenegro (2000-2010).

## PROFITABILITY OF THE BANKING SECTORS

The profitability of the country's banking sector has improved significantly over the decade. This was a result of the general reform of the banking system (writeoff of non-performing loans, privatization of state-owned banks, introduction of modern banking techniques, credit expansion) and the high intermediation spread in these countries (Stubos, Tsikripis 2004).

Generally speaking, the banking sector in Montenegro has experienced an upward trend in profitability. The sector in Montenegro gained profits in 2002, 2003, 2005 and 2006, while losses were made in 2001 and 2004, as well as in 2008 and 2009. The losses in December 2001 totalled 1,116 thousands euro, which were mainly due to problems experienced by Hipotekarna Banka. Because of the negative result in 2004, the profitability ratios – ROA and ROE – were below zero, respectively - 0.29% and - 1.2%. The situation improved in 2005. In December 2005 the banking



sector's gains were measured at 4,184 thousands euro, and this caused an increase in the ROA to 0.81% and in the ROE to 4.16%. During further years the banking sector's profits have decreased so radically that since 2008 the sector achieved losses what influenced the performance indicators, namely return on assets lowered below  $-0.62\%$ ,  $-0.68\%$  and  $-2.73\%$  respectively in 2008, 2009 and 2010.

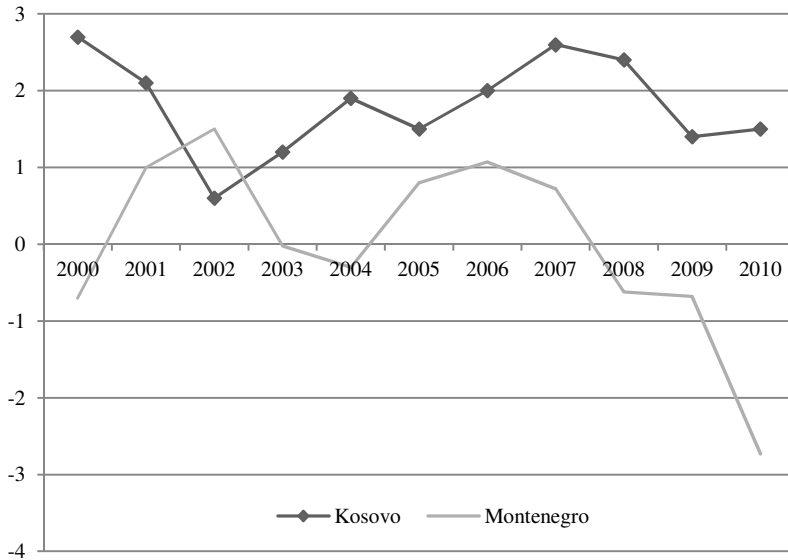
Since 2002, Kosovar banking sector has been profitable. There are two important aspect influencing the overall economic growth in Kosovo: the lowering of interest rates and the shift from short-term to long-term financing. Both of them enabled intensive long term capital investments. This is also reflected in the deceleration of the banking growth and the deterioration of the profitability of the banking sector. The basic indicators of banking sector's performance illustrate favorable picture throughout the whole period. The net profit has been continuously climbing since 2002. The highest net profits achieved in 2007 and 2008 – respectively 33.5 million euro and 36.4 million euro – resulted in relatively high return on assets and return on equity. In 2010 Kosovo's banking sector gained net profit of euro 32.9 million, which was 30 % higher compared to 2009 but almost 10% lower comparing to 2008, indicating an improving performance of banking sector after the slowdown of 2008. This was a consequence of the faster growth of commercial banks income, mainly due to the increase of lending activity. But between 2008 and 2010 it was noticed that a faster growth of expenditures comparing to income influenced the net profit negatively. The banking sector experienced the decrease of net profit which is reflected by a significant decline of banking sector profitability indicators, which decreased by 1 pp in case of ROA (from 2.4% in 2008 to 1.5% n 2010) and by 9.7 pp for ROE (from 24.7% in 2008 to 15% in 2010).

Figure 9 presents the change of profitability indicator – return on assets – in both countries. Although the expenditure of banking sector in Montenegro is faster, the profitability is significantly lower, which can be explained by relatively high cost of this development.

The developments in the banking sector in Kosovo since the first quarter of 2009 show that the financial system in Kosovo is sustainable and there are no indications of any possible turmoil in the Kosovar banking system. The banks which conduct business in Kosovo were assessed to be safe banks and not affected by the global financial crises. According to the opinion of the Governor of the Central Bank of Kosovo, Kosovo has established a committee to combat any financial crisis erupting in Kosovo but there is no cause for concern at present<sup>3</sup>.

<sup>3</sup> See <http://www.newkosovareport.com/200905191778/Business-and-Economy/Kosovo-banks-safe-from-global-financial-crises.html>.



**Figure 9. Return on assets in Kosovo and Montenegro (%)**

Source: own calculations based on data from Central Banks of Kosovo and Montenegro.

## COMPARISON

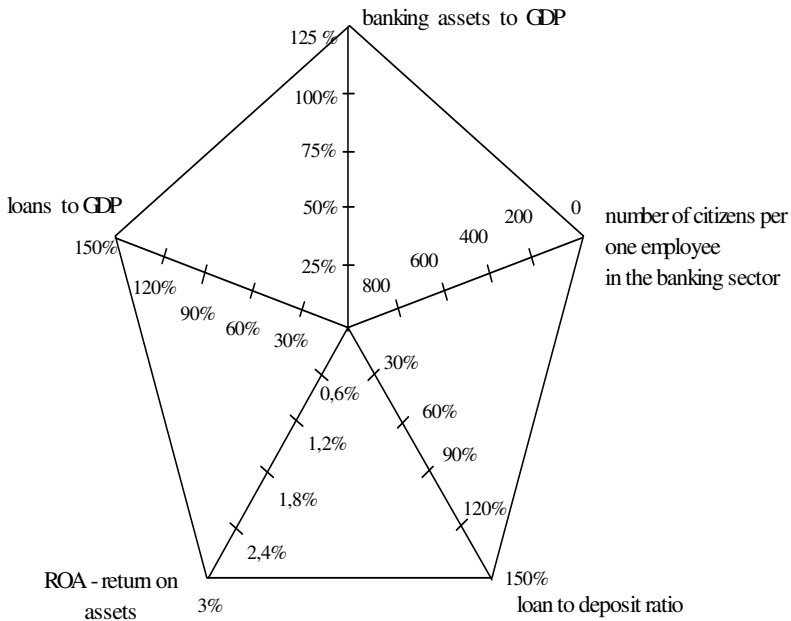
In order to compare the general situation of banking sectors in Montenegro and Kosovo macroeconomic stability pentagon, introduced in Poland by Institute for Market, Consumption and Business Cycles Research, has been adopted by replacing macroeconomic general indicators like GDP growth, rate of inflation, unemployment rate, budget deficit and foreign debt, where the last two are presented as % of GDP, with such data which could simultaneously compare and present current situation on a banking market. The indicators illustrating banking sectors, as presented on the figures 10 and 11, include banking assets/GDP, total loans/GDP, return on assets in a banking sector, number of citizens per one employee in the banking sector and loan to deposit ratio. The abovementioned indicators present various aspects of a banking sector: its volume and value, profitability and liquidity as well as citizens' access to banking sector. Although the most reliable indicator presenting ability of the population to use the banking sector is number of banking accounts, since these date are treated





as top confidential due to marketing competition, it is assumed that the more people is employed in the sector, the better access to products and services the clients can receive. Therefore, the number of employees in the banking sectors is considered in this aspect. Moreover the indicators are placed in the specific way. The bigger part is colored the more developed banking sector is.

**Figure 10. Pentagon of banking sector development**



Source: author's work.



**Figure 11. Comparison of development of banking sectors in Montenegro and Kosovo**

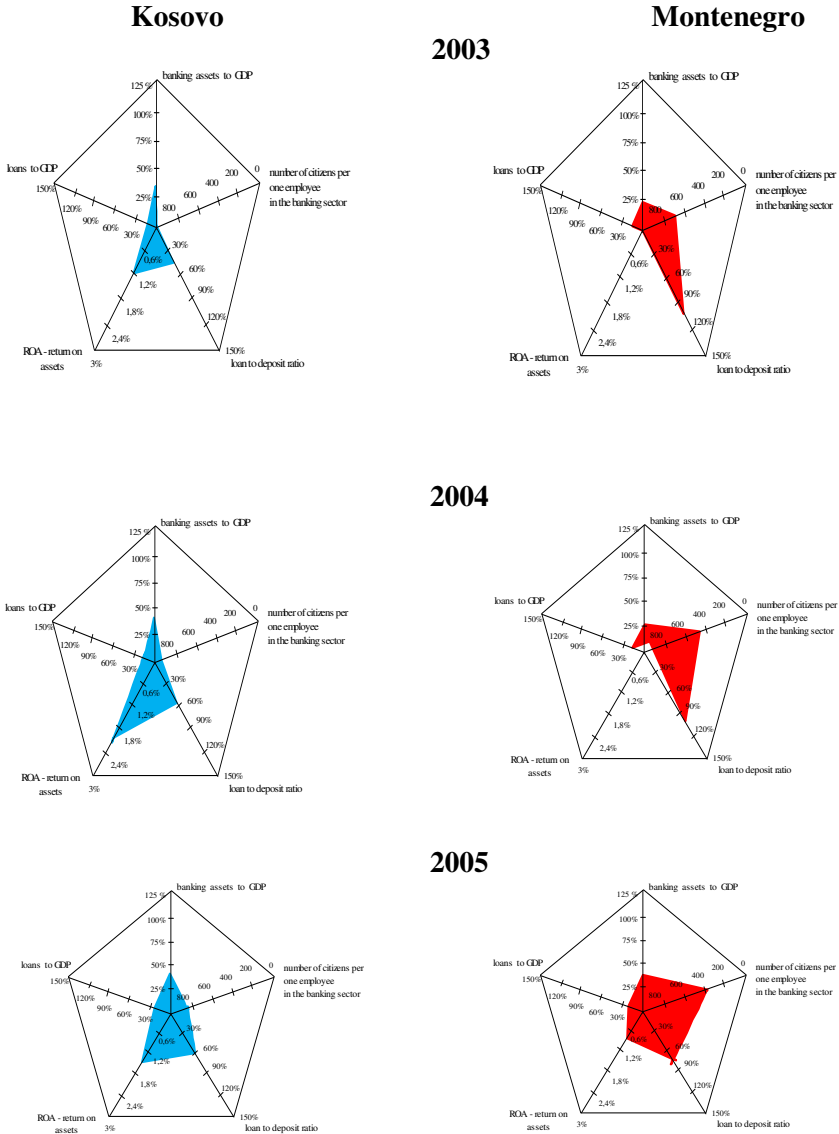
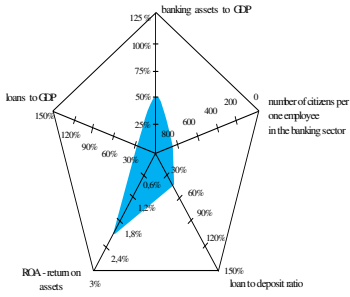
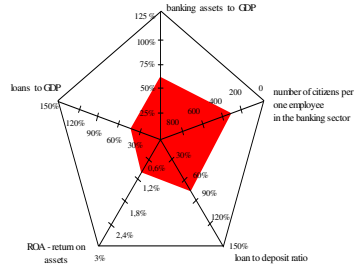


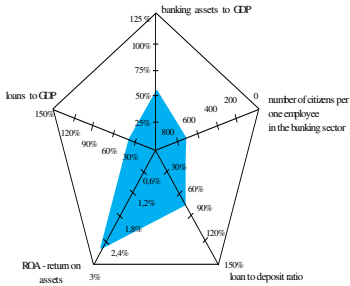
Figure 11 Continued



2006



2007



2008

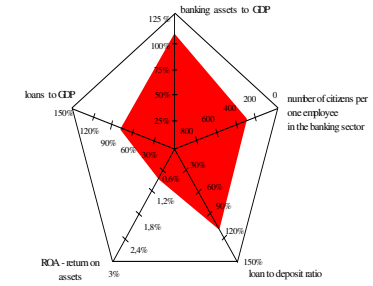
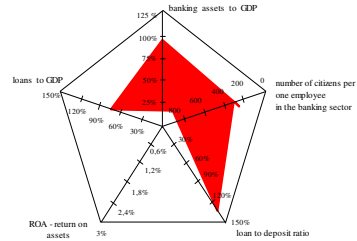
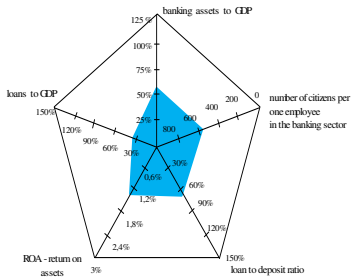
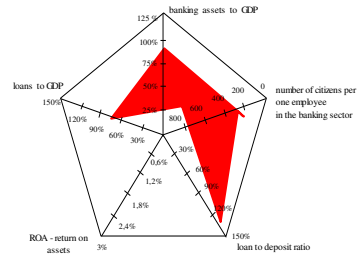
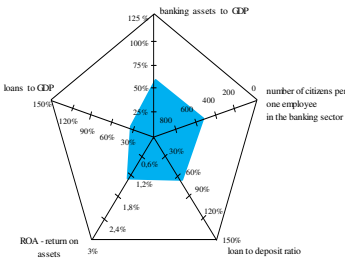


Figure 11 Continued

2009



2010



Source: author's calculations based on data from Central Banks of Kosovo and Montenegro (2002–2010).

As it was mentioned above, the bigger pentagon is colored, the more developed the banking sector is. It is easily noticeable that in case of Montenegro the pentagon is relatively bigger although the negative impact on its size has got performance of the sector below zero. Only between 2005 and 2007 return on assets reached positive figures.

In the case of Kosovo, the size of pentagon grows continuously, which proves smooth development of the whole banking sector. It should be stressed once again that Kosovar banking sector has been built from the scratch, although it has not reached the value of rates achieved by Monte-



negro's banking sector which are taken into consideration in this comparison. Kosovo was the last country in the region which started to transform its economy into market economy, including building a modern banking sector. The country had to cope with two types of problems. On one hand, it inherited a bad reputation from the former Yugoslav period when the clients lost their deposits. On the other, there was a lack of know-how in terms of advanced banking, which was gained thanks to inflow of foreign investments. The presence of investors from countries with sophisticated banking sectors was the main accelerator which led to the adopting modern banking practices, with special emphasis on constant launching of new banking products and modern risk assessment practices.

The banking sector in Kosovo also stimulates the economic growth in the country, which is its big advantage. Although the active loans of the banking system have reached only 30% of country's GDP, which is relatively low comparing to Montenegro, where the amount of loans/GDP is approximately three times bigger, it must be stressed that financing of these loans in Kosovo mainly comes from the deposits collected inside the country (see table 8 for loan to deposit ratio). This explains why the commercial banks are not exposed to cost and supply of capital from the foreign sector. It also proves that there is still space on the market for new products, new clients and new institutions. Nevertheless, financial intermediation presented as banking assets to GDP is still two times lower in Kosovo than in Montenegro, because the cost of mediation in the Kosovar system is still considered to be high. In terms of liquidity measured with loan to deposit rate, banking sector in Montenegro reached a relatively high level of value, above 100%. This proves that, on one hand, this kind of activities is relatively well developed, but on the other it may influence negatively the financial results of the whole sector. ROA below zero is mostly accompanied by increase of non-performing loans (NPL). In the case of Montenegro, NPL to total loans has raised in the moments when sector has obtained losses, which is presented in table 1.

**Table 1. NPL as % of total loans and ROA in Montenegro**

Details	2003	2004	2005	2006	2007	2008	2009	2010
NPL to total loans	4,7	5,7	5,2	2,9	3,2	7,2	13,5	17,3
ROA	-0,02	-0,3	0,8	1,07	0,72	-0,62	-0,68	-2,73

Source: author's calculations based on data from Central Bank Montenegro.



Higher returns (measured with ROA) in Kosovar banking sector derive from the application of conservative loan policies by banks and conservative supervision by the regulator. The other thing is that participation of bad loans in the overall portfolio of the banking sector is low, which proves that this banking sector is among the sectors with the best quality of loan portfolio in the region (Lubrani 2010).

The banking sector in Monetrangro was in much more convenient situation just before the transformation process has begun, because it had the advantage of already existing and operating banking infrastructure. In terms of size of the banking sector (measured with banking assets to GDP), the Montenegrin one is growing much faster than the Kosovar banking sector, which can be explained with more liberal policy, especially between 2005-2006, than in Kosovo. In that period, not only did the total assets grow significantly, but banks' capital did as well. These changes were accompanied by significant amendments in ownership structure. Therefore, when we turn to access of citizens to banking sector, the access to the banking sector can be assumed to be easier in Montenegro than in Kosovo because in Montenegro there are more banking employees comparing to the national population.

## CONCLUSIONS

The economic development and reforms of each country of South and Easter European countries during the 1990s can be ranged from shock-therapy type to gradualism. Misguided gradualism was used in Montenegro, and it usually appeared in the beginning of transitions in countries with weak institutional sectors. Results showed that the best reforms were in those banking sectors that used partial shock therapy with active gradualism.

After several years of turmoil in the 90's, the banking sectors in Kosovo and Montenegro have stabilised. This is because a number of measures have been put in place, including the separation of commercial banks from the central bank, liberalisation of interest rates, cleaning up of loan portfolios, restructuring and privatisation of state banks and their enterprise borrowers, and the opening up of the banking system to private and foreign entities at an early stage of the transition process. Foreign-owned banks account for the vast majority of the region's banking assets and provide a competitive benchmark for the remaining domestically-owned banks. (*Banking sector...* 2008)

The growing economic strength in Kosovo and Montenegro will allow the financial institutions to improve their performance and expand their



activities. However, so far, the convergence towards the EU banking sector which was expected to be advantage is low, but ought to increase in the near future.

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