COMPETITION, EFFICIENCY AND BANKING STABILITY IN KOSOVO

Fitim MEXHUANI, PhD candidate
European University of Tirana
Faculty of economics
Profile: Financa

ABSTRACT

The main purpose of this paper is to provide a theoretical overview, concrete and analytical functioning of the banking sector in Kosovo. Almost all customers use banking products and services. If the market works the best, then welfare certainly would be higher. Taking into account the special characteristics of the banking market, it is assumed that increasing the level of competition, it could increase the level of welfare, but it is frequently objected that it could be dangerous for their stability. Initially analyzed indicators of competitiveness, efficiency and stability of the banking market. analyzing all the indicators, the analysis shows a lower level of competition in recent years. Secondly estimated costs and benefits of competition in this market. Empirical analysis shows that there is a higher degree of market power, which results in increased overall cost efficiency. Although the power of the market has an impact on risk-taking, it seems that its impact on the overall banking risk is insignificant. This means that when policymakers seek optimal structure, they should be guided more by the efficiency of the market as long as there are regulatory policies.

Keywords: Competition, efficiency, banking, financial stability, loans.

INTRODUCTION

The banking industry is characterized by the problem of moral hazard, which incursion banks to take on more risk. That can lead to too great social cost. Furthermore the trend of globalization is modifying the structure of banking markets around the globe, pointing out the serious issues that have sensibilitelin conjure those with financial and competition. Issues such that become even more acute for other post-communist countries since they established banking systems are relatively new and inexperienced.

The banking industry in Kosovo, as well as in many other countries suffered significant structural changes during the period of economic transition that continues. Banker market liberalization of foreign banks and entry brought equally to the capital market where foreign participation is dominant in relation to local government. Initially it seemed that the competitive environment will be present where banks expanded their network, introduced new products, improved quality of service and more engaged in activities with higher returns in an attempt to protect their market share and to ensure financial stability performance. This led to a more efficient use of their financial resources, including their capital.

Purpose

Given this problematic main factors that motivated me to do this study are:
Matters pertaining to competition in the banking market and its effects are particularly strategically important for the countries in transition between them and for our country, because the banks operate as the main actors in channeling funds from the lender to the borrower. Because investments are particularly sensitive to declining, loan rates

monopolistic profits and reduction of the cost inefiqenca would consequently impact on investment and growth.

The entry of foreign capital in the banking system of Kosovo is among the highest in the region. And according to some theories, the level of competition will be expected to be high. But the impression that foreign banks are beginning to get used to high profits, and may not be ready and driven to destroy this aggressive behavior, further reinforced the idea of undertaking this study.

The banking market is special in many aspects. Competition is generally regarded as a positive force, often accompanied by increased efficiency and increase consumer welfare . The existence of very few studies on these issues and the lack of other methods different from the traditional and simple to assess the level of competition and efficiency in the banking market, was a motive more to make this choice.

Methodology - The survey takes analysis a range of qualitative and quantitative elements, which influence or determine the level of competition, market structure and concentration, the behavior of consumers and their access to the system, the behavior of banks to price.

Banks and characteristics that make them special and banking market

Banks as financial institution develop its business based on the principles, methods and scientific achievements. Certainly the application of the above mentioned elements determines further development of the business. Once, Too potential progress with respect banking principles, analytical methods and scientific innovations, it is necessary that a policy enforcement. When talking to a financial institution such as a bank then you should know that its business of who is? Dealing mediation leading banks in the creation of money (deposits) and placement or granting credit form. But financial market characteristics make banks must also perform other services, whether they want to be competitive. According to the literature of traditional mediation, it said that the main function of the financial system is to enable transfer of funds from lenders to borrowers and to transfer income from the borrower back to the lender.

Providing liquidity to the financial system (allowing easy sharing of an asset to another), division of risk (allowing savers to keep more active) and information (collection and communication). There are two types of financial institutions to achieve this, financial markets, which contrast direct depositors and borrowers, and financial intermediaries that confront them indirectly. Dealing indirectly widely known as financial intermediation. Mediation exists because the transaction costs of intermediate exchange are lower than direct transaction costs between market participants. Transaction costs can be lower, because the mediator has an address known and quality. He will compare the market participants with the highest probability in a shorter period of time. Thus, sellers and buyers reduce their costs of research and negotiation time.

In Europe, the functions of deposit, investment and securities of financial institutions have traditionally been provided under the umbrella of universal banks. Universal banks differ from traditional banks, because the latter are composed of banks in which the actual operations are providing loans and accepting deposits from the public (Freixas and Rochet, 1997)

Why banks are special?

Banks are special for a number of reasons:
First, an important difference between non-financial firms is that banks provide as product, funds instead of producing any physical good. What makes this task more complex, is that banks share in financial contracts (loans and deposits), which are not readily marketable.
A second reason, why banks are special is that there may be economies of scope to a significant degree. Fixed organizational costs imply economies of scale, while providing joint activities of deposits and loans can produce important economic goal.
A third characteristic is the existence of externalities external, related to the fragility of a player. In particular, the failure of a bank can be contagious and spread to other banks. The consequences for the economy can be much more serious than in large-scale failures of non-bank firms due to the force devastating infestation of bank failure.
A fourth characteristic is related to the assumption that asymmetric information is quite significant, which increases and the probability of failure of the market.

The theoretical competition, efficiency and banking stability

The theoretical competition, efficiency and banking stability Transformations in the banking system in transition countries, have led to major changes in the structure of the banking industry. These changes have raised concerns about competition and consumer welfare, as himself in this kind of market competition is complicated. This complication on is due of impact on financial stability. From the standpoint of welfare, costs accompanying financial crises can be considerable, and has opportunity to be borne with difficulty compared with the inefficiencies that may result from the centered banking markets.

Financial System in Kosovo

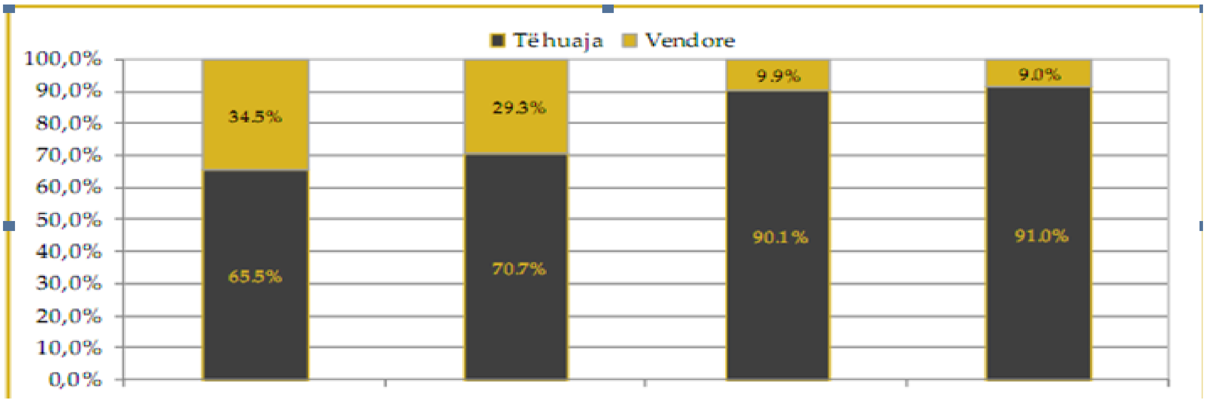
Growth and development of the banking sector (2000-2010) it's accompanied with the establishment of banks and growth the numbers of their, with expansion of products offered, with expansion of geography covering the entire territory of the country. Even though is ascertained one effort of the continuous banking operators for securing a wider base of clients by increasing the competition, this growth still has not had substantial effects in lowering of Interest rates in credits and lowering of the change between interest rates on loans and deposits which is higher.

Kosovo's banking system currently consists of the Central Bank and commercial banks. The activity of all commercial banks in Kosovo at the present stage of development financial operational flows from creation The chained of deposit and credit. The sector banking Kosovo was added a new bank at the end of 2012, raising so the number of commercial banks in nine (9). According to the ownership, the structure of the banking sector remained similar with periods precursory, where dominate the banks foreign-owned[1].

From total of nine banks operating in the banking market, seven are foreign owned and constitute about 91.0% of banking sector assets, while two have local ownership and manage the remaining assets of about 9.0%.

[1] De Haas and Lelyveld (2006) focusing more on the impact of foreign bank capital in the banking system's stability.

Pic 1. The structure of bank assets



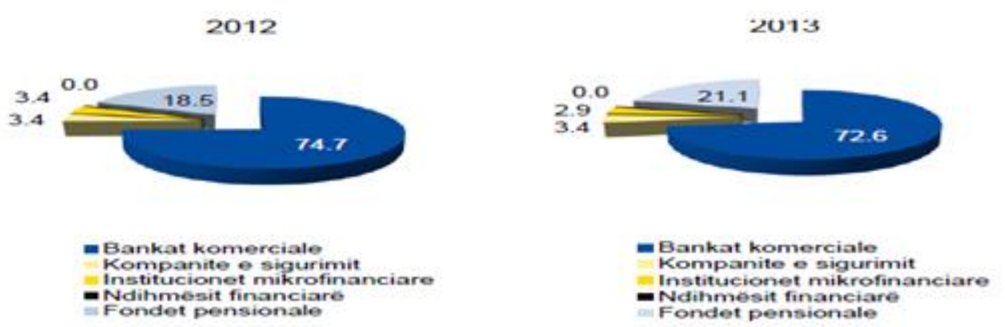
2010 **2011** **2012**
2013

Source: CBK (2013)

The activity of the financial system in Kosovo continued to widen, by maintaining the a satisfactory level of sustainability in all its constituent segments. Until June 2013, The total value of assets of financial system amounted to 3.8 mld.€, representing annual growth from 8.1 % (8.0% in June 2012).For difference from previous year, financial system assets have started recovery of the increasing rhythm and the main contribution to this growth had assets of pension funds. The banking sector remains the key segment of financial intermediation in place, assets of each represented 72.6% the total assets of the financial system in June 2013 (74.7% in June 2012).

The accelerated growth of pensions fund assets[2], the second segment from by size in the financial system, influence the increase of their participation to 21.1% of the total assets in the financial sector in June 2013 (18.5% in June 2012 and 16.8% in June 2011). Regarding the other segments, the share of assets of insurance companies remained unchanged from the previous year to 3.4%, while the share of assets of microfinance institutions continued to dwindle descending into 2.9% of the total assets of the financial sector (3.4 % në qershor 2012).

Pic.2- The structure of the financial system



Source: CBK (2013)

---

[2] Management of pension funds made by Pension Savings Trust

The structure of the financial system in Kosovo remained similar to previous periods in terms of number of financial institutions which operating in the financial market in place.

Table 1: Number of financial institutions

The number of financial institutions			
Description	**2011**	**2012**	**2013**
Commercial banks	8	9	9
Insurance companies	13	13	13
Pension funds	2	2	2
Financial auxiliaries	34	38	39
Microfinance institutions	20	17	17

Source: CBK (2013)

While after licensing of branch Türkiye İş Bankası number of commercial banks operating in Kosovo increased to nine (9) at the end of 2012, the number of companies in the insurance industry has remained unchanged since the last thirteen (13) and the number of pension funds 2. A significant part of the assets of the financial system of Kosovo (including CBK) continue to be invested abroad, while utilization of financing from abroad is still at a relatively low level. The value of assets external net (NFA) in June 2013 amounted at about 2.35 billion euros, an annual increase of 13.0% (4.7% annual growth in June 2012). Looked by individual sectors, the data show that the CBK has shifted an part of the investments from deposits right the securities, while commercial banks have diminished their investment in the external sector in deposits and in securities ,while pension funds have continued to invest in stocks and other equities.

In June 2013, total liabilities of the financial system of Kosovo to the external sector reached a value of 440.4 million (annual growth of 21.0%).Liabilities to non-residents mainly consist of loans that financial institutions operating in Kosovo have received from financial institutions operating abroad .In June 2013, the domestic sector demand reached a value of 11.1 billion euros, representing an annual increase of 5.1% compared with annual growth of 25.8% in June 2012.Domestic sector requirements consist primarily of claims on central government and claims on the real sector.

Banking stability

To assess competitiveness in the bank is important to stop the financial stability and its impact on the development of the banking sector and the level of competition. Factors that influence financial stability are: stable macroeconomic environment; effective and safe supervision of the supervisory authorities; functional infrastructure of the banking market means banks, insurance companies and microfinance institutions and their behavior in the market is transparent, competitive and functional. Main risks leading to instability of financial stability are: credit risk, liquidity risk, interest rate and equity risk.
Credit- risk loans generally constitute the largest group earning assets. Loan quality has a significant impact on the current and future income. The quality of the loan portfolio can be controlled through prudent lending policies and administrative controls, and taking into consideration the efficiency of the judicial system.
Interest- rate risk arises from the mismatch between assets and liabilities sensitive to interest rate. The degree of mismatch can significantly affect earnings depending on its size and direction of movement in interest rates.

ISSN 2056-6018

Liquidity risk[3] - occurs when the bank is not able to meet the demands of depositors and commitments to lend. To the difficulties of liquidity may be due to the large differences between the maturity of loans and deposits, not deposits stability, poor quality assets and what is more important because of poor management of liquidity daily and longer.
Capital- risk of insufficient capital resources and limited possibilities of action in the market can make the bank to lose its depositors, increase the cost of funding, not to be able to support the expansion of activity, suffer reduced capacity to absorb losses, reduced profitability and in extreme cases be insolvent or bankrupt.

Competition in the banking sector

Banks have played a fundamental role in financing the economy, but so also believed that banking competition positively affects economic development. A higher degree of competition in banking markets is expected to provide increased welfare by reducing prices of financial services, thus accelerating investment and growth. Economists choose the competition, because it stimulates the market players to be more efficient.

Competition Policy

The instinct of every company is to try to avoid competition. Therefore, it is the duty of the authorities to monitor the market to competition, in order to limit behaviors anticompetitive firms. The objective of competition policy is to promote competition among firms to increase efficiency and reduce costs, leading to increased consumer welfare. In the US, the banking sector has been subject to competition[4] law after 1960, while in Europe it was after the 1980 laws on mergers, cartels and abuse of dominant position. In many places, even in developed economies, competition laws are not effectively implemented in the banking sector (and Kawana Yokoi-Arai, 2007). However, after the financial crisis of 2007-2008, the role of competition policy grew (Vives, 2010).

According to the recommendations of the OECD (1998b), the competition law should be fully implemented in the banking sector (banking regulation in parallel with). On the other hand it recommended that banks should not be subject to the rules of their "special" competition, but be subject to the general rules of competition. Very often it is proposed that a section be subject to its own particular rules of the competition, on the grounds that the sector is very important in a sense or another "special".

This proposal should be treated with caution as the competition rules are comprehensive and flexible to an extent sufficient to include any special feature of the sector. Special laws for the sector are more likely to be amended and implemented in the interest of the regulated industry rather than in the interest of the economy as a whole. On the other hand the general laws tend to be better protected and in this way to sustainable and enduring. In general, competition policies refer to three different types of business practices, cartels, abuse of dominant position and concentrations.

Cartels are any agreement and / or cooperation in the market behavior of firms, which aim or effect the prevention, restriction or distortion of competition. Examples of anti-competitive cartels are agreements which directly or indirectly fix selling prices or acquisition or any

[3] Prof.dr. Siniša Ostojiç ''Osnovi monetarne ekonomije'', Beograd 2009, fq.102
[4] Fredric S.Mishkin, Columbia University,

ISSN 2056-6018

other trading conditions, which allocates markets or sources of supply, limiting production, markets, technical development or investment.

Abuse of position dominant related any anticompetitive behavior opportunity to exercise one or more companies, who hold a dominant position in the market. A firm holds a dominant position when it can act as independent as competitors as well as consumers, who have a limited ability to react to this behavior. The main examples of abuse of dominant position are pricing or terms and conditions that are unjustified or acting in a way that prevents the entry into the market by competitors, or forces them to exit the market. Dominant position in itself is not forbidden, but what is prohibited is the abuse that comes from a dominant position in the market.

A concentration (or fusion) occurs when two (or more) companies, initially divided, merged, or when a firm buys control of one (or more) companies, enabling it to have a decisive influence on this (these) firm. A merger is prohibited if it creates or strengthens a dominant position, which, directly or indirectly, prevents the existence or development of effective competition in the market. On the other hand, a concentration may be authorized, but given that the focus changed to eliminate any anti-competitive effect. These arrangements are often "structural", but could be in principle the "behavior", however, behavioral adjustments are often difficult to be "was implemented. There has been a growing trend of mergers in Europe, reaching a maximum around when introducing the Euro, but then we drop it, and especially in countries.

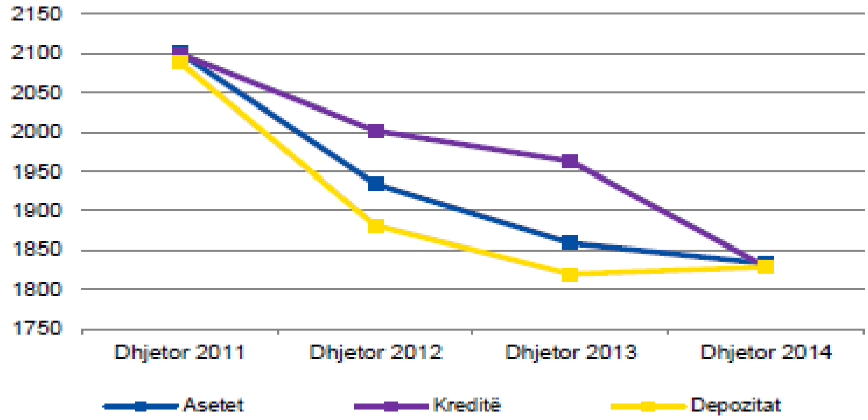
Western Europe (Berger, 2007). Also, Vives (2010) shows that there is a positive trend regarding the consolidation of the banking market, be it within a country or between countries. All three of these elements of competition policy in the banking sector are implemented. However, given the structure of the market in this sector, particularly cartels and concentrations appear to play a larger role than the abuse of dominant position. Cartels in the banking sector and in particular in the market include the payment system services (services that display some natural monopoly characteristics).

School bank favors free competition and decentralization of money supply on central banks, and also favors the removal of the government from the monetary system (White 1999, f.219). However, competition in the banking sector can work to the detriment of consumers and threaten the stability of the banking system due to the inherent market failures. For this reason the banking sector has been subject to regulation and supervision rather than watchful competition authorities.

Meanwhile, the definition of "relevant market" becomes even more necessary in the implementation of competition policy. The purpose of the market in two dimensions, product and geography, is to identify the actual competitors who are able to restrict the behavior of others and prevent independent behavior by the pressure of effective competition. In Kosovo, the definition of the relevant market comes under the Law No.03 / L-229 and up for amendment, Law No.04 / L-226 "On Protection of Competition", the Competition Authority, The Banking System in Kosovo continues to be characterized by a high degree of market concentration, where 77.4 percent of total banking system assets managed by the three largest banks. The two largest banks, ProCredit Bank and Raiffeisen Bank have a share in the credit market of 68%. None of these banks on the basis of the Law on Protection of Competition does not have a dominant position since they do not exceed the limit of 40% of market share. However, it should be noted that the continuous increase of activity of smaller banks has affected the degree of concentration in the banking market continued to decline from the prior year.

The degree of market concentration in the banking sector has continued to decrease during 2014. The share of assets of the three largest banks, in December 2014, decreased to 66.9 percent compared with 67.4 percent in the previous year. The decline in concentration is observed through the Herfindahl-Hirschman Index (HHI), which shows a steady decline in the concentration of assets and loans during the period from 2011 to 2014 (Figure 3). The decline in concentration in assets and loans was the result of faster growth of assets and lending to smaller banks alongside slower growth of assets of the three largest banks.
Three largest banks in December 2014 recorded a growth of 3.7 percent in assets and an annual decline of 0.1 percent in loans, compared with annual growth of 6.2 percent on assets and 13.9 percent on loans of other banks. On the other hand, the index suggests slight increase in the degree of concentration in deposits during 2014, despite the downward trend followed during the previous three years. A slight rise in concentration in deposits in 2014 was the result of higher deposits increased in the three largest banks (annual growth of 4.4 percent) compared to the growth of deposits in other banks (annual growth of 2.1 percent).

Pic.3- HHI for assets, loans and deposits



Source: CBK (2015)

Efficiency

It means achieving of a goal to lower costs. This is enough important in a world with scarce resources. Understanding the most natural and intuitive way of competition is that individuals are free to enter the business, when they find it useful to do this, not leaving without untapped opportunity to win. An efficient banking sector provides the largest contribution to economic growth and prosperity simultaneously. Banks contribute more to growth by fostering the accumulation of capital through credit supply.

Two aspects are important in this regard: the amount of credit offered and its efficient distribution. Theories distribution efficiency different show its implications on credit and growth. Under a traditional industrial organization of market power leads to higher deposit rates and lower offer of placements, exerting negative pressure on growth. The second group of theories, market power can improve the function of production through better information to banks (through relationship lending and examination), improving efficient allocation of capital. OI in the traditional framework, technical efficiency achieved by perfect competition. Formal designation of technical efficiency by Koopmans (1951) is: Increasing production requires reduction of an output of the at least one other or increasing the output of at least one other input.

Measuring efficiency

The issue of bank efficiency measurement is treated from different angles. Different settings require different methodologies efficiency of its measurement. Traditional methods of measuring the efficiency associated with the analysis of various financial reports, such as ROA, ROE, net interest margin. Several other studies have attempted to identify the characteristics that explain differences in bank efficiency; p.sh the bank's size, form of organization, market characteristics (such as concentration) and specific banking variables such as age and the ratio of bank loans to total assets. However, these methods do not consider the value of management actions or decisions on investments which will have its impact on the future.

Table 2: Key indicator of the efficiency of the banking sector, in percentage

Description	2011	2012	2013
Operating Expenses / Total assets	3.70%	3.60%	3.30%
Net interest margin	6.30%	6.00%	5.70%

Source: CBK (2015)

SUMMARY AND RECOMMENDATIONS

Banking sector in order to increase competition, a detailed study of the main transactions bank in the position of the client, banker and supervisor, to understand all the complexity of the sector, the functioning of the further behavior of this market, we need recommendations with the aim of enhancing financial stability and increased competition:

- The growth and development of the banking sector is accompanied by the establishment of banks and increase their number, with the expansion of products offered, with the expansion of the geographical scope to cover the whole territory. Even though found in a continued effort of the operators bank on providing a wider base of customers by increasing competition, this increase has not had significant effects on the reduction of interest rates on loans and reduce the differences between interest rates on loans and the deposits is high.
- The capital of existing banks is dominated by foreign capital and the percentage of local capital is low, there is a need to become the growth of new banks and their spread across the country.
- There should be liberalization of the banking market through the licensing of new banks, namely the need to increase the number of banks operating in Kosovo,
- Asymmetry of information, expressed in the inability mainly to individual customers and small businesses to find information summarized, comparative update for all banks, to provide all information required by the banks to make their choices. This is partly due to their limited ability to process information and in part by the lack of effective information giving banks. This makes product selection and its providers more difficult for consumers and reduces pressure banks to compete with prices, at least for certain products or service quality.
- A lack of transparency, clearly shown by the inability of customers to compare effectively the services offered by banks has contributed to a low level of customer opportunities to move. These circumstances create the possibility for providers to raise prices above the competitive level of the market without losing market share. Furthermore the process of changing consumer Bank is a difficult process, costly and usually takes time. Lack of information to the client obliges it remains "blocked" in a particular bank and "transfer costs" for him to be higher.

ISSN 2056-6018

- In terms of an inactive money market and in the absence of capital market customer deposits remain the primary source of generating funds in the banking system.
- The power of banks in the credit market where competition is stronger, can be said to "splits" between banks. Generally they maintain a high profit margin, compared with the costs (interest basis), with aggressiveness or withdrawal from the market.
-An Interactive process of Government securities and trust funds, insurers, would play an important role in mitigating the dominant position of commercial banks in this market. This creates competition and pressure for more transparency and information.
- Feels needs to determining the rating of banks with international credit institutions that provide funds through which to directly influence interest rates.

REFERENCES

Adrian, T., Shin, H. (2008), "Liquidity and Financial Cycles", BIS Working Paper Nr. 256,

Angelini, P., Cetorelli, N. (2003), "The Effect of Regulatory Reform on Competition in the Banking Industry ", Journal of Money, Credit and Banking, 35(5), 663-684,

Berger, A.N., Demirguc-Kunt, A., Levine, R., Haubrich, J. (2004), "Bank concentration and competition: An evolution in the making ", Journal of Money, Credit and Banking 36, 433-451.

The Kosovo Competition Authority, (2011), Competition Monitoring Analysis of Commercial Banks in general and the banking sector in Kosovo ,

Central Bank of Kosova, Annual Report 2012,

Central Bank of Kosova, Annual Report 2013,

Central Bank of Kosova, Annual Report 2014,

Central Bank of Kosova, Annual Report 2015,

Cani, Sh., Muço, M., Baleta, T. (2000), "Sistemi bankar shqiptar. Probleme të zhvillimit të tij ", Përmbledhje e analizës së vrojtimit, Banka e Shqipërisë.

Daniel Gros , Niels Th Peter Rose: Money and Capital Markets, Homewoood, Illinois, Richard Irwin, 1989, The fourth part European monetary integration,London,1998

Gazmend Luboteni, Bankat dhe Afarizmi Financiar ,Fakulteti Ekonomik, Prishtinë 1998

Gazmend Luboteni, Menaxhmenti Financiar i Bankave Afariste,Fakulteti Ekonomik, Prishtinë ,1998

Friedman, J.W. (1971), "A non-cooperative equilibrium for supergames", Review of Economic Studies 38,

Frederic S.Mishkin, “The Economics of Money, Banking and Financial Markets,10th Edition”

Peter S.Rose: ’’Bankarski menadžment i financijske usluge’’Beograd, 2005,

Suela Kristo, 2011, “Konkurrenca, efiçenca dhe stabilitetit bankar në tregun shqiptar”,

Stiglitz, J., Weiss, A. (1981), "Credit Rationing in Markets with Imperfect Information", American Economic Review 64, 851-866.

Tihomir Jovanovski, Financiski Pazar,Skopje,1994

Zhivota Ristiq, Terzhishta novca,teorija i praksa,Beograd,1990

Willem H.Buiter, Giancarlo Corseti,Paolo.A.Pesenti:Financial Markets and European Cooperation,Cambridge University press,London ,1996.