

# THE ROLE OF FOREIGN DIRECT INVESTMENTS IN THE DEVELOPING OF BANKING SECTOR

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## Abstract

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The important factor of a stable economy undoubtedly remains foreign direct investment (FDI), which helps in the establishment and economic, social and overall development of a country. Corporations that decide to invest their capital abroad of the country of origin, obviously require the destination country to have an organizational economic viability and attractive and suitable legal space. Meanwhile, the factors that affect the size, structure, benefits, costs and role of the banking sector of FDI in the economy of Kosovo will be objects of analysis of this paper. In addition to these issues, we will present the real situation of FDI in general during the last years in Kosovo, the origin of the respective countries from which these investments come and their economic activity scope. For the writing of this paper, the method of secondary data analysis and comparative method were used. Mainly, we have used the publications of the Central Bank of Kosovo (CBK), such as Financial Stability Reports and Monthly Information Reports of the Financial System. In this paper, it is concluded that FDI makes the main contribution to the development of the banking sector in Kosovo as well as in developing countries.

**Keywords:** Banking Sector, Capital, Foreign Direct Investment, Assets

**Authors' individual contribution:** Conceptualization — E.B. and B.S.; Methodology — A.R.H. and M.H.; Investigation — B.S.; Resources — E.B. and A.R.H.; Writing — Original Draft — E.B. and B.S.; Writing — Review & Editing — E.B., A.R.H., and M.H.

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## 1. INTRODUCTION

Investments are a very strong basis for the economic development of any country, especially countries in transition, such as Kosovo. Driven by technological change, global competition and market liberalization, foreign investment plays a key role in the process of global economic integration.

Attracting foreign direct investment (FDI) is one of the most important strategies for developing countries to increase capital formation in order to generate a higher amount of gross domestic product (GDP). FDI brings the necessary capital, increases the productivity of the economy through the

transfer of knowledge and technology, affects the opening of new markets for trade, increases economic competition, affects the reduction of the current account deficit, increases employment and above all affects the well-being of the population. Kosovo has great potential to become an attractive country for FDI as well as to attract capital, information and technology.

The term “foreign direct investment”, includes two related groups, but having different topics and activities, which are explained by different theories and branches of economics. The first is called international finance, or the macro perspective, while the second is called the industrial organization, or micro view.

According to the Organisation for Economic Co-operation and Development (OECD, 2008), FDI is a category of international investment in which an entity resident in one economy (direct investor) takes a lasting interest in a company resident in another economy (direct investment enterprise).

The lasting interest means the existence of a long-term relationship between the direct investor and the direct investment company as well as a significant degree of influence towards the latter.

The terms “direct investor” and “direct investment enterprise” are defined by the International Monetary Fund (IMF) and the OECD as follows: A direct investor can be an individual, a legal or natural person, a public enterprise, a government, a group of individuals or legal entities and/or individuals who own a direct investment enterprise with activities in a country outside the direct investor’s country of residence. A direct investment enterprise is a legal or natural person in which a foreign investor owns 10% or more of the shares or voting power of a commercial company or the equivalent of a partner (OECD, 2008).

When different analyzes are done that include FDI either as a dependent or independent variable, researchers have differences in the conceptualization of FDI measurement. Some of the researchers, such as Neuhaus (2006, p. 98) and Olofsdotter (1998) give priority to the internal stock of foreign investments, while other researchers (Herzer et al., 2008; Johnson, 2006) as representatives of FDI take initial inflows of FDI in the relevant year in a country. In this paper, the line of the first group of researchers will be followed, that of the internal stock of foreign investments, for the reason that the banking sector is a regulated market and it cannot be expected to have a continuous inflow of FDI, as it can happen in the real sector, but it is important to observe the growth of the internal stock of external capital in the banking sector.

This paper aims to analyze the importance of FDI in the development of the banking sector and the whole economy in Kosovo.

This paper aims to answer these research questions:

*RQ1: What is the general level of FDI in the banking sector of Kosovo?*

*RQ2: What is the ratio between foreign and domestic capital in the banking sector in Kosovo?*

*RQ3: How does Kosovo stand with FDI in the banking sector compared to other countries in the region?*

The objectives of this study are:

- to show the importance and contribution of FDI in the banking sector in Kosovo;
- to empirically analyse the role of FDI in the development of the banking sector in Kosovo and the countries of the Western Balkans.

Although the research is limited to the geographical context in Kosovo and the countries of the Western Balkans, we think that the results from this research can apply to all developing countries.

The structure of this paper is as follows. Section 2 reviews the relevant literature. Section 3 analyses the methodology that has been used to conduct empirical research on the developing banking sector and the impacts that FDI have on its

development. Section 4 shows the results of this empirical research. Section 5 discusses the finding and results of this research. Section 6 summarizes the conclusions of this study.

## 2. LITERATURE REVIEW

There exists voluminous literature on FDI and its determinants. Bevan and Estrin (2000) reported that country risk, unit labour costs and host market size are the major determinants in Central and Eastern Europe. The size of the host market, even creating free trade zones through regional agreements, as well as unit labour costs to attract FDI in Central and Eastern European countries are also supported by Krasniqi et al. (2022).

There are three important sets of determinants that influence the FDI inflows, namely, the presence of ownership-specific competitive (*O*) advantages in a transnational corporation, the presence of location advantages (*L*) in a host country, and the presence of superior commercial benefits internally in a firm (*I*) (Dunning, 1993).

Moosa and Cardak (2006) in their study of 138 countries concluded that countries with a high degree of openness and low country risk attract more FDI.

Access to finance and positive cash flows are important factors for enterprises especially small and midsize enterprises (SMEs) to make investments in the country (Bajcinca, 2015; Krasniqi & Mustafa, 2011). So, developing the financial, especially the banking, sector is crucial to support business activity and developing a country.

Kida (2018) finds that high-interest rates in the financial and banking sectors have had an impact on the attraction of FDI in the banking sector in Kosovo.

FDI is a major source of external financing which means that countries with limited amounts of capital can receive financing across national borders from wealthier countries. Investments are important factors for maintaining, raising and developing the economy of a country (Marenga et al., 2022; Shiyalini & Suresh, 2022).

Investments in the financial sector will have a significant impact on the national economy. Foreign investments provide the liquidity required by countries. Özdemir and Öncü (2019) find that GDP growth has a significant and positive effect on the financial sector. The growth of the economy increases the profitability of the companies and thus the profitability of the banks.

Perhaps one of the most complete studies in terms of the number of countries analyzed was done by Clarke et al. (2001), who used survey data from more than 4,000 firms operating in 36 countries. The authors found that foreign bank participation decreased the financing constraints (as perceived by firms’ managers) of all firms in the economy. Although they also reported evidence that suggests that entry by foreign banks benefits large enterprises more than small enterprises, they did not find indications of any harm to SME finance. It is worth mentioning that even if foreign banks enter the domestic market in order to serve large corporate customers, increased competition in the wholesale market may force domestic banks to channel resources to SMEs while they begin

the process of selecting among them the most creditworthy clients.

In essence, the notion of investment means the dedication of material goods for a certain purpose, and as a general term, investment is quite broad and complex, which is conveyed by different dynamics from the sources of material means to the objective of the last investor.

FDI is a category of investment by the resident enterprise (direct investor) in one economy, with long-term business interest in another economy from the country of origin of the direct investor. When a company has at least 10% of the voting share capital owned by foreign investors, the company can be classified as an FDI for a host country resident of the foreign investor (OECD, 2008).

Southard (1931, as cited in Lima, 2016) suggests that FDI includes two related but different activities addressed by different theories or different branches of economics. The first point of view is based on international finance, otherwise called macroeconomics. The second perspective is related to industrial organization, otherwise called microeconomics.

The macroeconomic perspective sees FDI as a special form of capital flow across national borders, that is, from countries of origin to host countries, measured by balance of payments statistics. These capitals increase a particular form of stock in the host country, that is, they increase the value of incoming investments in these countries, specifically corporations controlled by a local owner or corporations where the local owner has a certain level of shares. The variables of interest are the flow of financial capital, the value of the capital stock that has been accumulated by investing firms, and the income flows from these investments.

The microeconomic perspective tries to explain the motives for controlling foreign investment operations from the investor's point of view. This also examines the consequences that derive from this investment for the investor, for the host countries, and then the consequences that come from these operations of the multinational companies or of the subsidiaries created by these companies instead of analyzing the flow rate or the value of the investment stock or the state of these investments. These consequences arise from the way their trade is carried out by employment, production, investment flow and the stock of intellectual capital, which is analyzed separately, that is, separated from the balance of payments and stock analysis. These motives and consequences deeply relate to the control that multinational firms have over their subsidiaries and the ability that these investment or international companies have to coordinate activities with their subsidiaries. The micro perspective is the oldest. This kind of view predates direct investment interest as a form of capital flow. Different theorists and researchers over the years have presented their concerns regarding these investments and have analyzed the consequences that the control of foreign economies brings to the host economy.

*Foreign portfolio investment* is a type of investment that takes place in international financial markets and is considered by all economic agents, such as individuals, firms and local or national governments.

Foreign portfolio investments refer to such transactions involving the purchase and sale of equity securities, debt securities in the form of bonds, notes, money market instruments and financial derivatives with the exception of classified securities, such as direct investment and fund reserves (Ridgway, 2004).

### 3. RESEARCH METHODOLOGY

The methodology of writing this paper is based, in addition to the literature review, on the empirical and comparative methods. The last two methods use secondary data for the respective years, which we have collected from the Central Bank of Kosovo (CBK) and the central banks of neighboring countries. The data obtained from the CBK have served us to see the dynamics of FDI in the banking sector in Kosovo, but also for the structure and growth of assets of banks with mixed domestic-foreign capital in Kosovo. The data obtained from neighboring countries are compared to FDI in the banking sector of these countries. Comparing the FDI of the banking sector in Kosovo with those of neighboring countries gives us a good overview of where Kosovo is in this aspect, but also neighboring countries as well.

We are aware that the best methodology was not used, but we believe that even with this methodology we have established a good basis for measuring banking development as a result of FDI.

An alternative methodology would be to do it through linear regression and measure the impact of FDI through the effects method by measuring incoming FDI in each year on the impact of the growth of banking sector assets. However, because the expectations are that the FDI inflow in the banking sector every year is decreasing due to the saturation that the sector reaches with capital, this method could be unfavorable for measurement.

### 4. RESULTS

The financial system of Kosovo consists of 6 types of financial institutions that include: commercial banks, pension funds, insurance companies, financial assistants, insurance intermediaries, microfinance and non-bank financial institutions.

According to the annual reports and historical evidence from the Central Bank of Kosovo, the banking sector constantly has the main contribution to the expansion of the activity of the financial system in the country.

The performance of the banking sector since 2012 had an increasing trend both in the number of services offered and also in the number of financial institutions. The table below shows the increase in the number of banks, financial assistants and microfinance institutions in 2021.

**Table 1.** The structure of financial institutions in Kosovo

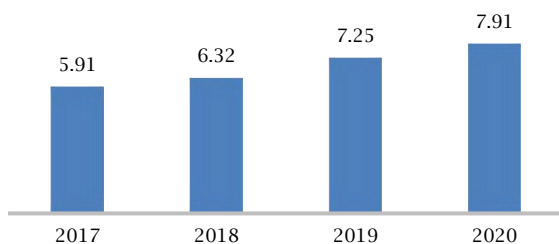
<i>Financial institutions</i>	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Commercial banks	9	9	10	10	10	10	10	10	11	11
Pension funds	2	2	2	2	2	2	2	2	2	2
Insurance companies	13	13	14	14	15	15	14	13	13	12
Financial assistants	38	39	42	44	48	43	50	50	57	53
Insurance brokers	17	17	18	18	16	16	16	18	18	19
Microfinance and non-bank financial institutions	20	17	18	18	22	25	29	29	29	30

Source: CBK (2021a).

The financial system showed an increase in activity during 2020, despite facing the challenges of the health and economic crisis caused by the COVID-19 pandemic. All constituent sectors contributed to growth at a rate that was slower compared to the previous year. The value of the assets of the financial system reached 7.91 billion euros, which coincides with an annual increase of 8.9% (an increase of 14.9% in 2019).

The financial intermediation rate (the ratio of assets to GDP) increased by 13.8%, to 116.2%, mainly influenced by the decline in GDP in 2020 as a result of the negative impact of COVID-19 on economic activity in the country and outside of it.

In the framework of the assets of the banking sector, the items that had the greatest contribution to growth were loans and the balance with CBK, while the increase in the assets of the microfinance sector is mainly attributed to the increase in the balance with commercial banks. The pension sector, despite the withdrawal of 10% of funds from contributors<sup>1</sup>, recorded an increase in assets, made possible by the increase in contributions received during this period as well as by the positive return from investments. The assets of the insurance sector also expanded, with a more pronounced increase in the category of deposits held in commercial banks (mainly in the form of time deposits), followed by investment in the securities of the Kosovo Government.

**Figure 1.** The value of financial system assets in billion euros

Source: CBK (2021b).

The most pronounced improvement is noted in the component of negative deviation to the average rate of capitalization of the sector, which means that banks have converged towards the average rate of capitalization of the sector, this is a result of the increase in the rate of capitalization of smaller banks alongside the decrease of the average rate of capitalization of the sector (CBK, 2021a).

<sup>1</sup> According to Law No. 07/L-16 on economic recovery — COVID-19, contributors to the Kosovo Pension Savings Fund have the right to withdraw up to 10% of the amount they have saved in their accounts in order to overcome the financial difficulties incurred from the COVID-19 pandemic.

#### 4.1. Legal framework for the licensing and regulation of banks in Kosovo

The Central Bank of Kosovo has continuously tried to provide favorable conditions for the licensing of commercial banks and the regulation of their field of activity. Among the legal acts that help in the opening, licensing and regulation of banks in our country are:

*Law No. 04/L-093 (Law on Banks, Microfinance Institutions and Non-Bank Financial Institutions)*, approved by the Assembly of Kosovo in 2012. The purpose of this law is to promote and maintain a stable financial system through the promotion of sound and prudent management of banks, microfinance institutions and other non-bank financial institutions, and ensuring an appropriate level of protection of depositors' interests. Based on this law, banks are initially organized as joint stock companies and are registered at the Ministry of Trade and Industry (MTI), where all shares are registered in the name of their beneficial owners, the shareholders. However, in order to operate as a bank, first the proof of registration must be presented to the Central Bank of Kosovo and then the joint stock company is regulated only by the Central Bank of Kosovo according to this law. Based on this law, all banks operating in Kosovo must have the act of establishment and/or the statute, as well as the constituent bodies of the bank are presented: 1) general meeting of shareholders, 2) board of directors, and 3) top management.

*Regulation on Licensing of Banks and Branches of Foreign Banks.* This regulation defines the conditions, requirements, procedures and deadlines to be followed for the application and granting of a license for a bank and/or a branch of a foreign bank. Based on this regulation, the applicant for a banking license to carry out banking activities in the Republic of Kosovo during the establishment process and before obtaining the final license must deposit for this purpose in the CBK a minimum initial capital in the amount of not less than 7 million euros, in compliance with the requirements of Article 15 of the Law on Banks. The foreign bank that applies to carry out banking activities through its branch must keep a deposit in the CBK in the equivalent of the capital, not less than 7 million euros as defined by Article 17 of the Law on Banks.

#### 4.2. The banking sector in Kosovo

The consolidation of the banking sector in cooperation with the regulator authority, the Central Bank of Kosovo, has produced a new spirit,

contributing positively to the environment of doing business and opening new opportunities, which directly serve the clientele of the banking sector and not only.

The sustainability of the banking sector in Kosovo and the direct contribution of the CBK to provide a stable financial system have made the banking industry one of the main pillars of the country's economic development. The development of the banking sector over the years has impacted the increasing demand for loans, the value of deposits has also marked a continuous increase, while the non-performing loans have marked a gradual decrease, accompanied by a decrease in interest rate. The creation of a regulatory framework together with the willingness of banks to create new operating infrastructure has made this very important sector maintain stability in the market. In addition to the efficient operation that the banking industry has managed to prove, within a short period of time it has managed to implement an international standardization framework, modernize banking services and offer very attractive

and innovative products, creating new opportunities to improve the environment general business in the country and increased competition (Lumezi, 2019).

In recent years, the banking sector has focused on digitalization and operational efficiency. In this regard, adaptation to international trends in Kosovo has been quick and timely. Digitalization in the banking sector helps in reducing operational costs and reduce risk while making the country a potential center for the development of financial technology products (fintech). In Kosovo, people are familiar with banks and are enthusiastic about using banking products, while this is supported by banks with large networks of more than 200 branches across the country. The number of commercial banks in 2020 operating in Kosovo increased to 11, as a result of the licensing of a new bank with foreign capital. While the number of microfinance institutions and non-banking institutions decreased to 18, as a result of the withdrawal of the license of two institutions (CBK, 2021a).

**Table 2.** Structure, activities, performance and interest rate of commercial banks in Kosovo

<i>Description</i>	<i>2017</i>	<i>2018</i>	<i>2019</i>	<i>2020</i>	<i>2021</i>
<b>Structure</b>					
Number of banks	10	10	10	11	11
Degree of concentration	61.1%	57.3%	56.9%	55.8%	52.5%
Foreign ownership	88.1%	86.8%	86.7%	86.5%	85.5%
Number of employees	3,320	3,225	3,331	3,391	3,518
<b>Activities</b>					
Asset value	3,877.5	4,183.9	4,755.7	5,353.1	5,959.5
Loans	2,485.3	2,755.5	3,031.9	3,246.4	3,748.6
Annual growth of loans	11.5%	10.9%	10.0%	7.1%	15.5%
Deposits	3,092.5	3,364.6	3,908.1	4,358.8	4,901.8
Annual growth of deposits	6.7%	8.7%	16.2%	11.5%	12.4%
Own capital of banks	471.6	496.7	520.2	611.0	642.6
<b>Performance</b>					
Income	241.2	252.8	263.2	279.3	322.1
Expenses	155.9	165.8	176.9	199.4	204.6
Net profit	85.3	87.0	86.2	79.9	117.5
<b>Effective interest rate</b>					
Interest rate of loans	6.8%	6.0%	6.4%	6.0%	5.8%
<i>For households</i>	7.3%	6.3%	6.8%	6.2%	6.0%
<i>For businesses</i>	6.5%	6.0%	6.2%	5.9%	5.7%
Interest rate of deposits	1.3%	1.5%	1.6%	1.5%	1.3%
<i>For households</i>	1.0%	1.4%	1.4%	1.5%	0.9%
<i>For businesses</i>	1.7%	1.5%	1.7%	1.5%	2.0%
Differences of interest rate loan -deposits	5.5%	4.5%	4.8%	4.5%	4.5%

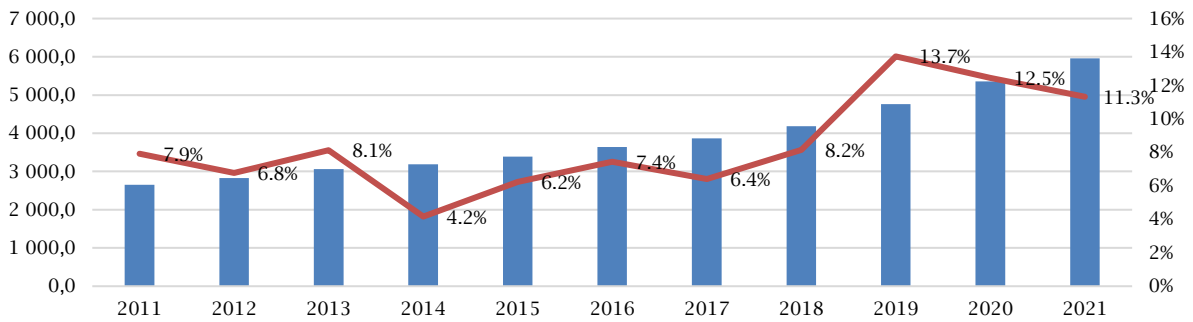
Note: The values are expressed in million euros, unless otherwise specified.

Source: CBK (2021a).

The assets of the banking sector recorded an annual increase of 11.3% in 2021, reaching a value of 5.96 billion euros. Despite the restrictions on economic activity during the COVID-19 pandemic, the assets of the banking sector recorded a slower growth compared to the previous year, which is mainly attributed to the dynamics in credit activity, as the main contribution to the assets of the banking sector. This activity is mainly supported by deposits, which make up about 81% of total liabilities and own resources. Based on the latest

data, the total assets value of Kosovo banking have upgraded to 6.7 billion euros by the end of 2022. The assets of the three largest banks have reduced their share to 52.9% of the sector's assets from 55.8% in the previous year (CBK, 2023). From the figure below, the flows of the annual growth of banking assets can be observed, which can mainly be considered positive, from the results we see that the year 2019 had the highest annual growth of 13.7%.

**Figure 2. Total bank assets and annual growth**

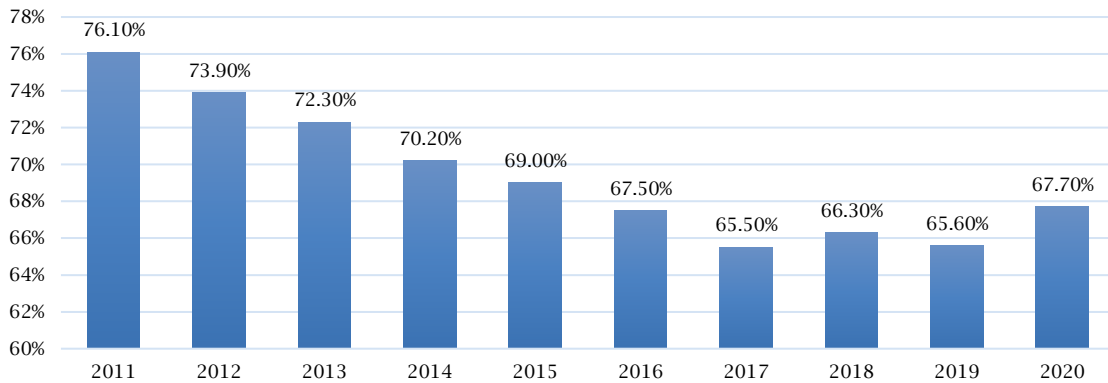


Source: Authors' elaboration.

From the annual reports of the Central Bank of Kosovo, the structure of assets of commercial banks has the distribution presented in the figure below, where the largest percentage of assets consists of

gross loans, followed by cash and securities. In 2021, the participation of gross loans was 62.9%, cash with 14.1% and securities with 11.5%.

**Figure 3. The participation of the banking sector in the assets of the financial system**

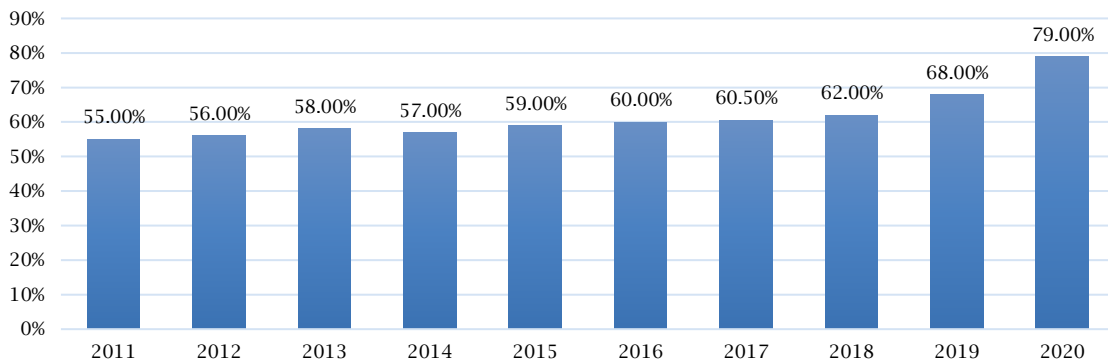


Source: CBK (2021a).

Based on the data presented in the previous figure, we note that the participation of the banking sector in the financial system over the years was different based on the percentage of participation. In 2011, we had the largest percentage of participation in the banking sector with 76.1%, but the pension sector had the smallest participation in the financial system with 17.0%.

The lowest participation of the banking system in financial assets was in 2017 with a total of 65.5%, this was the lowest point of participation of this sector in the financial system, the participation in 2020 of the banking system was 67.7%.

**Figure 4. Ratio of banking sector's assets to GDP**



Source: CBK (2021a).

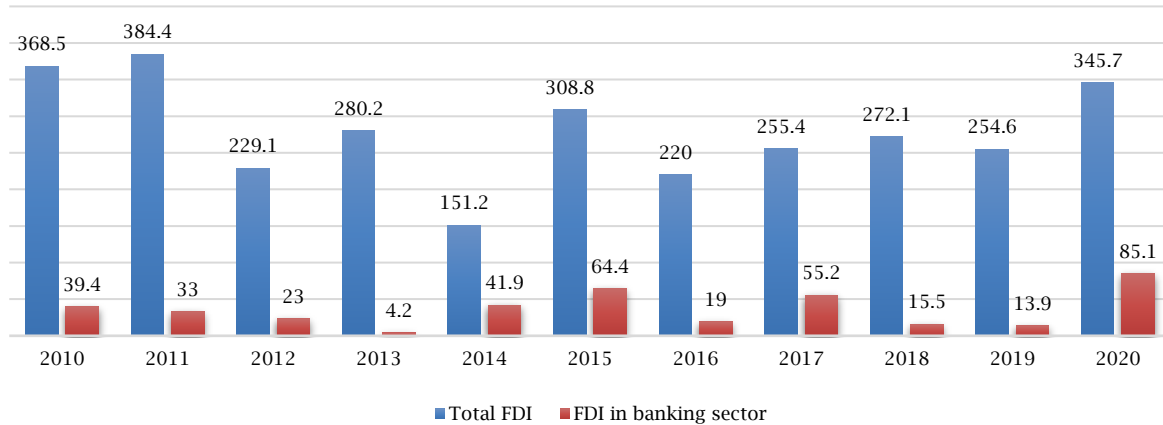
## 5. DISCUSSION

the process of economic and banking transition that our country is going through is a determining factor for foreign investments.

### 5.1. Foreign direct investments in the banking sector in Kosovo

FDI had variable flows over the years as far as the banking sector in Kosovo is concerned since

Figure 5. Total FDI and FDI in the banking sector by years, in million euros



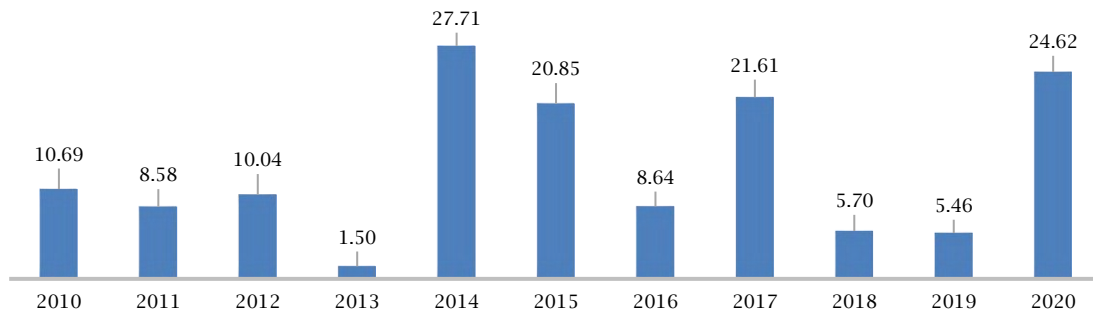
Source: CBK (2021c).

From the data presented in the figure above, we notice that the FDI in the banking sector was quite low compared to the total FDI in Kosovo.

In general, we had the highest FDI in 2011 with a total of 384.4 million euros, while the lowest in

2014 with a total of 151.2 million euros. As for FDI in the banking sector, we had the highest value in 2020 with a total of 85.1 million euros, while the lowest value was in 2013 with 4.2 million euros.

Figure 6. Participation of banking sector flows in FDI in total FDI in Kosovo, in %



Source: Kosovo Agency of Statistics (2021).

FDI in the banking sector expressed as a percentage had different fluctuations in terms of years. The lowest percentage was in 2013 with 1.5% (4.2 million euros) in relation to 280.2 million euros in total foreign investments in Kosovo. While the highest percentage of FDI in the banking sector was in 2014 with 27.71% (41.9 million euros) in relation to 151.2 million euros, while in 2020 we had the largest amount of foreign investments in the banking sector expressed in percentage 24.62%.

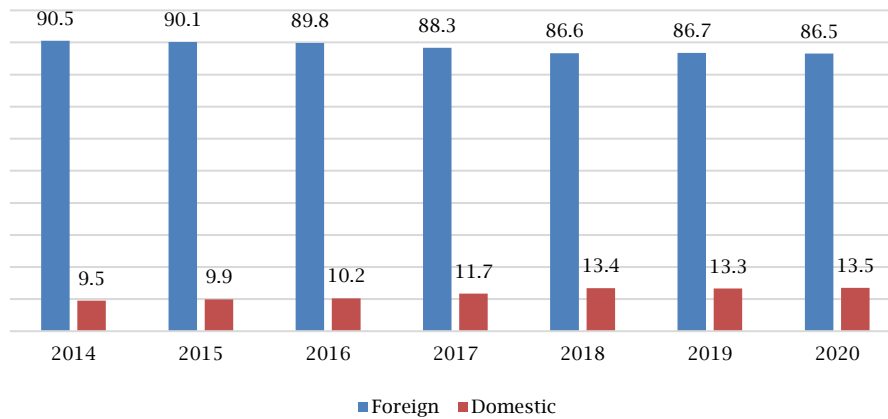
The average of foreign investments in the banking sector between 2010 and 2020 was

35.87 million euros or 13.22% of total foreign investments in Kosovo.

### 5.2. Capital of foreign banks in the banking sector of Kosovo

Foreign capital dominates most of the banking sector in Kosovo. Foreign-owned banks continue to dominate the structure of the banking sector in the country.

**Figure 7.** The ratio of foreign-domestic banking capital in the banking sector



Source: CBK (2021a).

In 2014, 90.5% of the bank capital was owned by foreigners, in 2015, foreign capital decreased slightly, being positioned at 90.1% of the total bank capital, the small decrease in the foreign capital continued in 2016, being positioned at 89.8% of the total bank capital.

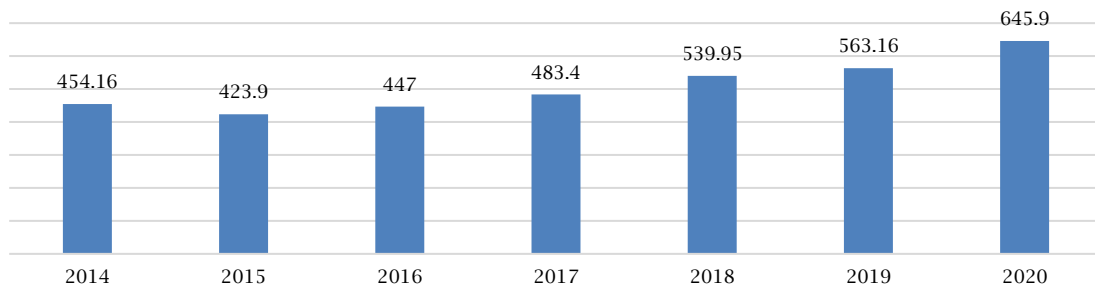
In 2017, foreign capital in the banking sector was 88.3% of the total banking capital, and here we can see the presence and interest of banks from the European Union (EU) to invest mainly in the banking sector. In this year, banks from the EU had a total of 61.0% of the banking capital, while banks originating from Turkey had 16.5% of the banking capital in the country.

Over the years, foreign banking capital has slightly decreased, so in 2020 the participation of foreign capital in the banking sector in Kosovo was 86.5%, of which 55.8% was held by banks originating from the EU, while banks originating from Turkey had a participation of 16.0% in the total bank capital.

The local bank capital received from the years presented above had a slight increase over the years, from 9.5% in 2014 to 13.5% in 2020.

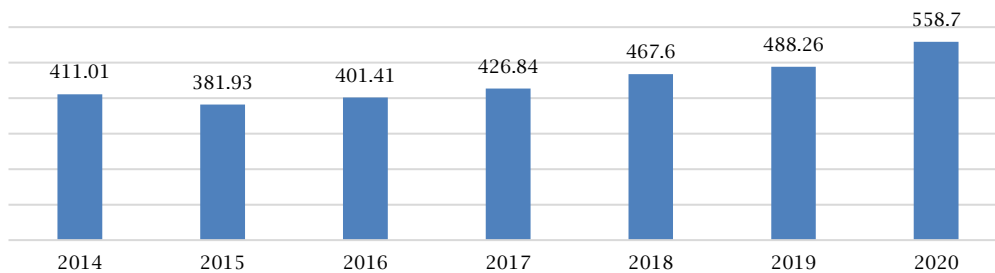
Banking capital in Kosovo in the years 2014 to 2020 was always in continuous growth, except for 2015 where compared to 2014 there was a decrease of 6.8%.

**Figure 8.** The total capital of the banking sector in Kosovo, in million euros



Source: CBK (2021a).

**Figure 9.** The value of the capital of foreign banks in the banking system, in million euros



Source: CBK (2021a).

The value of the capital of foreign banks in the banking system in Kosovo, expressed as a percentage, continues to be quite dominant since foreign banks have a large presence of capital in

the banking system in Kosovo, this proves that the value of FDI in the banking sector from foreign banks is quite high.



The further role of foreign-owned banks in the banking sector of Kosovo can be seen by analyzing their contribution in three dimensions: the number of employees, the number of units and

the value of the assets in the total value of the assets of the banking sector, which data are presented in the following table.

**Table 3.** The participation of banks with foreign capital in the banking sector of Kosovo, with the number of employees, units and assets value share

Years	Number of employees		Number of bank units		Participation in the total value of assets in the banking sector	
	Banks with foreign capital	Domestic banks	Banks with foreign capital	Domestic banks	Banks with foreign capital	Domestic banks
2018	2555	670	166	56	86.80%	13.20%
	79.2%	20.8%	74.8%	25.2%		
2019	2626	705	160	57	86.70%	13.30%
	78.8%	21.2%	73.7%	26.3%		
2020	2685	706	154	57	86.50%	13.50%
	79.2%	20.8%	73.0%	27.0%		
2021	2747	771	144	55	85.50%	14.50%
	78.1%	21.9%	72.4%	27.6%		
2022	2885	896	143	57	84.90%	15.10%
	76%	24%	71.5%	28.5%		

Source: Authors' elaboration.

As can be seen from the table, banks with foreign capital dominate the banking sector of Kosovo in the three aspects of the analysis. According to the number of employees, these banks during the analyzed period 2018–2022<sup>2</sup> employ about 76–79% of the employees of the banking sector. Some of the foreign banks<sup>3</sup> have organized academies or training departments to train their personnel. They also use the international network of their banks in different countries to exchange experiences among banks' employees. After the experience gained in these banks, a number of them have moved to less developed and local banks, in most cases taking managerial positions to give their contribution to the development of these banks. According to the number of units geographically distributed across Kosovo, foreign banks have 71–75% of the total bank units in Kosovo. The large number of bank units, about 200, has led to the rise of banking competition, which is seen through the decrease in the degree of concentration<sup>4</sup> every year, and increasing banking penetration among the population, where there is one bank unit for every 9,000 inhabitants. As for the third aspect analyzed, the participation in the value of the assets of the banking sector, foreign banks dominate even more, with 85–87% of the total value of the assets of the banking sector. Moreover, foreign banks dominate with 85% of the total number of loans issued to various clients by the banking sector since 2000. As mentioned above, the large number of bank branches and units geographically distributed throughout Kosovo have contributed to a high banking penetration. A few years earlier, some foreign banks in Kosovo started to set high price thresholds for basic services, in order to classify them, oriented towards businesses. However, the economic structure in Kosovo is not at the appropriate level of development, that's why the boomerang came back to these banks. Already,

they have begun to develop offensive marketing campaigns to attract customers to open accounts with them, offering them free account maintenance for a time.

Regarding the contribution of FDI in the banking sector, it is worth noting that Raiffeisen Bank of Kosovo, which is part of Raiffeisen Bank International (RBI) with headquarters in Vienna, has established with 100% ownership the first and main company in Kosovo which deals exclusively with financial leasing — Raiffeisen Leasing Kosovo<sup>5</sup>, which mainly deals with the financing of immovable and movable property for small and medium-sized enterprises and households, especially has supported financing of real estate.

Last year (2022), the European Bank for Reconstruction and Development (EBRD) supported Raiffeisen Leasing Kosovo with 10 million euros for micro, small and medium enterprises (MSMEs). This support goes for MSMEs in two directions:

- In support of the green economy through the financing of the purchase of electric cars and solar panels for the production of electricity, with 7 million euros;
- For the completion of technical standards and product certifications in harmony with EU standards, in the amount of 3 million euros (EBRD, n.d.).

The importance of these two projects is that the first supports the green economy and the social environment, while the second helps Kosovar businesses meet the standards to penetrate the EU market.

The development of financial leasing has also influenced the development of the microfinance sector in Kosovo, where leasing accounts for 20% of the value of assets in this sector (CBK, 2021b).

### 5.3. The level of FDI in the banking sector in the countries of the Western Balkans

The effects of globalization in the Western Balkans were quite positive for some countries in this region since positive progress has been made in recent years in attracting foreign investors to these countries, especially in the banking sector.

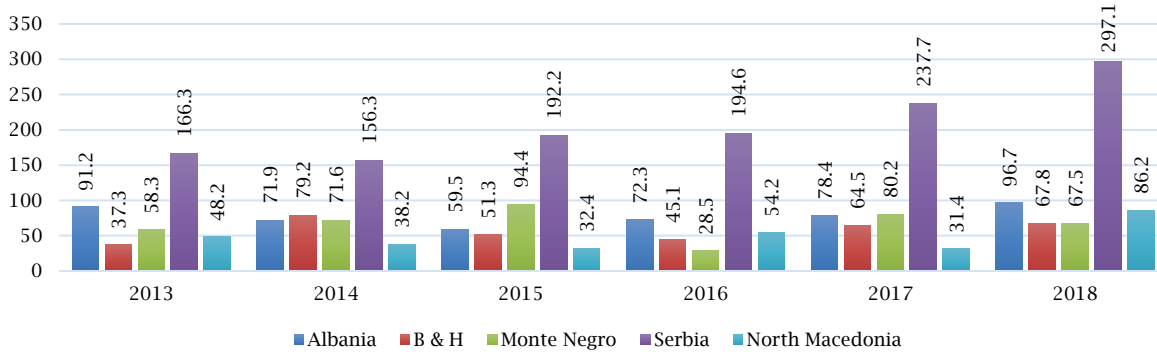
<sup>2</sup> The data are also for available the early years, respectively the first years of the 21st century, but in the paper they are presented only for the last 5 years, so as not to burden the paper too much. Even for the early years, foreign-owned banks dominate this level of employment participation in the banking sector.

<sup>3</sup> Pro Credit Bank and Raiffeisen Bank Kosovo.

<sup>4</sup> The degree of concentration represents the participation of the value of the assets of the three largest banks in the total value of the assets of the banking sector in Kosovo. In April 2023, the concentration rate is 52%, while at the end of 2013 was 67.3%. The data are taken from the publication of CBK (2023), for the periods referred to in the paper.

<sup>5</sup> RBI has such leasing companies in 11 other European countries.

**Figure 10.** The level of FDI inflows in the banking sector in the Western Balkans countries

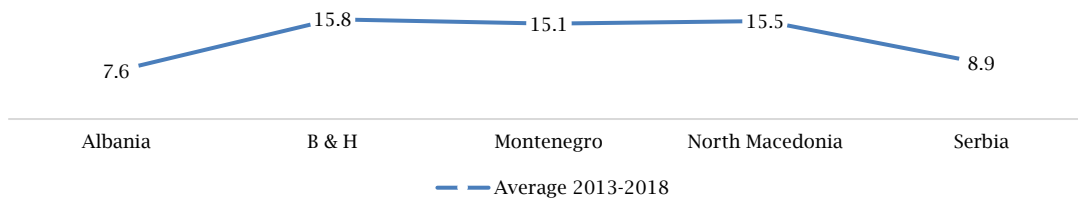


Source: United Nations (2019).

Based on the data presented in the figure above, where the FDI inflows in the banking sector of the Western Balkan countries are presented and

compared to the value of that in Kosovo, it is noted that the FDI inflows in the banking sector of Kosovo is lower than in any country in the Western Balkans.

**Figure 11.** Average FDI in the banking sector in 2013–2018 (expressed as a percentage) in relation to the total FDI in the country, for Western Balkan countries



Source: Topalli et al. (2021).

Regarding the participation of the FDI of the banking sector in the total FDI in a country, the figure above shows that the highest participation is in Bosnia and Herzegovina with 15.8%, followed by North Macedonia with 15.5%, Montenegro with 15.1%, etc. This indicator for Kosovo is 14.3%, which can be considered relatively good.

In Albania, in 2020 there were 12 banks, where 4 are with domestic capital and 8 with foreign capital, of which 6 are from EU countries. The ratio of domestic-foreign bank capital is 26.8–73.2% (Albanian Association of Banks [AAB], 2020).

In North Macedonia, 15 banks are operating. The ratio of domestic-foreign bank capital in North Macedonia is 25.3–74.7%.

In Serbia, in 2022 the ratio of domestic-foreign banking capital is 16.6–83.4%.

Looking over the years, the lowest amount of investments in the banking sector was in 2013 with a total of 4.2 million euros, while the highest was in 2020 with a total of 85.1 million euros.

## 6. CONCLUSION

Foreign direct investments are of strategic importance in Kosovo, they are a key factor in increasing the competitiveness of domestic products in international markets, supporting economic growth and increasing competition and production in the country's markets.

The banking sector, although made up of the majority of commercial banks, which are banks of other international countries, still remains

powerful banks, and with appropriate policies developed by the Central Bank, they can play a decisive role in the absorption of foreign investments, which would not only help strengthen and increase banking capacities but would also help create economic, investment and innovative stability in Kosovo.

Based on the research conducted related to FDI in the banking sector in Kosovo, where the years 2010 to 2020 were taken as an observation period, expressed in million euros, the total amount of foreign investments in the banking sector for these years was 394.6 million euros, where the average amount of FDI per year was 35.87 million euros.

Seen in relative terms, the average investment for the years 2010 to 2020 in the banking sector was 13.22% of total investments.

The capital of foreign banks in the banking sector in Kosovo was quite high compared to the capital of local banks, where the average capital assets of foreign banks for the years 2014 to 2020 was 88.35% of the total assets of banks in the country.

In general, foreign capital dominates the banking sector in Kosovo, since the results collected for the years 2014–2020 show that the share of banking assets owned by foreign capital in the banking sector is 3135.75 million euros, compared to the share of assets owned by capital reaches the value of 421.72 million euros.

During the research and consultation of the various theories that are presented in this paper, it is noticed that the focus of absorption of

investments in countries in transition is quite large, both for the investing company and for the host country.

Kosovo in relation to the countries of the region in terms of FDI in the banking sector is still at a low level of investment, however, foreign capital plays a crucial role in the banking sector in Kosovo. In addition to asset value, foreign banking capital has also impacted the employment of huge numbers of employees, the spreading of network banking, banking, and financial innovation. Regarding the sector supported, the banking sector including foreign banks has financed real estate, even through financial leasing.

The financial system, especially the banking sector, in the last 20 years has been considered a success story, as the most stable system within the economic system in general. This stability should be attributed to the wise and careful work of the Central Bank as a regulator and precisely to the foreign capital banks operating in Kosovo, which have come with a high standard of good banking governance.

Foreign capital in the banking sector is not enough to be seen only as an amount of investments, or to be highly valued if its participation is high compared to domestic capital. Foreign capital should be seen beyond this perspective, seeing also other benefits, first of all, along with foreign capital in countries in transition such as Kosovo and other countries of the Western Balkans comes managerial expertise in the field of modern banking, comes the culture of corporate governance that is very important in the banking sector, the introduction of new banking technologies, the development of a large number of banking products, a new approach to banking marketing, etc.

The limitations of the paper are that it is based only on secondary data and that no advanced statistical method has been used to measure the effect of FDI on the development of the banking sector. We consider that future research on this topic should be directed at measuring the effects of FDI in the banking sector in the aspects we just mentioned.

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