The impact of Euroization in Businesses' Access to Finance in Kosovo

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Abstract

The research explores the impact of Euroization on Kosovo's business access to finance. It attempts at answering the questions as to what extent has the Euroization impacted the business development by enabling the adequate access to finance. The research finds that the Euro adoption has brought about different benefits for the Kosovo economy in the context of enabling macroeconomic stability, which carries high importance. The macroeconomic stability and Euroization has been impacting the development of a sound financial sector and the development of business at large. The study concludes that there was a significant impact of Euroization in the core issue of business development satisfaction and access to finance for businesses. The data analyses show also that while there is a huge chance for the entrepreneurs to develop and expand their businesses, the scope of financing sources and the finance conditions requires improvement.

Key Words: Euroization, access to finance, business development, interest rates.

1. Introduction

Several surveys conducted in developing countries have shown that an inability on the part of enterprises and individuals to obtain credit is a serious obstacle to development. For the creation of new enterprises, credit incentives are more important than tax incentives. While tax incentives may help established enterprises in increasing their liquidity and development, credit incentives can have a wider impact in creating new enterprises (Tanzi, 1991).

The adoption of the Euro in Kosovo had many advantages in fostering financial stability and growth. However, given the high unemployment and interest rates of credit, and the difficulties in coordinating policies, Euroization continues to be a significant national economic and political issue, five years after the country's independence in 2008. An almost a decade of Euroization experience necessitates the review and its impact in various areas of economic development of Kosovo.

For the country's policy makers, it is a necessity to understand how their economic regulatory environment compares to the regulatory environment in other economies and how such an environment influences the business decisions and choices (World Bank, 2012). For instance, new-technology-based firms (NTBFs) choosing the strategy of rapid internationalization, decide on the foreign market entries that minimize transaction costs and the related risks of failure. Further, it is evidenced that in the entrepreneurial young firms' regulatory protection for their intellectual property matters a lot when determining their entrance choices (Regis and Gordon, 2008). In the context, the monetary policy choice plays its important part. An unstable monetary policy could cause a number of problems occur such as inflation and a rise in interest rates. An unstable monetary policy was becoming a hindrance in the economic development of Kosovo. Therefore, following the application of Deutschemark since 1999, the United Nations Mission in Kosovo (UNMIK) took a decision for implementing the Euro as Kosovo's main currency and officially adopted Euroization in 2002.

In common currency areas, the national authorities delegate monetary policy decisions to a supra-national authority, namely the common central bank (Bottazzi and Manasse, 2005). In the case of the European Union (EU), this authority is the European Central Bank (ECB), which has 27 fully integrated members, of which 17 have adopted the Euro as their legal tender. In January 2011, Estonia became the latest country to adopt the Euro (ECB, 2011). In such an institutional setting, it is the ECB that, after taking into account member countries' economic conditions, sets the monetary policy for the member countries, aiming for an inflation rate of 2% in a medium term of three years for the entire Eurozone. Conflicts of interests arise when national business cycles are not well synchronized within individual countries, and the ECB is faced with asymmetric information, which represents a challenge for policy formulation as countries in recession would favor more expansionary policies than those in expansion (Bottazzi and Manasse, 2005). The main priority in achieving the objectives of development of the Eurozone is price stability (European Union Treaty, 1992).

Alternative to full membership into the monetary system of European Union, Euroization was implemented by non-member countries unilaterally, although this is not recommended by the ECB. Kosovo and Montenegro are two countries of the Western Balkans that applied the Euro unilaterally despite not being members of EU; although they are aiming for full integration in the future. In the case of Kosovo it was the United Nation Administration, based on its mandate (UN Resolution 1244, 1999), which decided to use the Euro as Kosovo's official currency. Countries aiming towards full membership to the European Union are expected to meet certain strict economic, legal, and political criteria (European Union Treaty, 1992). At this point, Kosovo remains in the process towards the full membership in the EU but it remains unknown when it will happen.

1.1 Scope of the Research

The experiences of countries that have adopted a foreign currency, either officially, non-officially or unilaterally, remain under researched. Most of the research conducted about Dollarization/Euroization concentrate on the policy implication in macro level, highlighting its costs and benefits on theoretical grounds (Winkler et al, 2004, p. 4). The situation remains as such also in the case of Kosovo, as the few papers that have been written so far are mainly focused on the same level of macro policy implications (Likaj, 2006; Tyrbedari, 2006; Maloku and Pantina, 2011, these are few examples. The empirical approach of Dollarization/Euroization became apparent in a Rose study (2000), which provided econometric evidence of the trade effects of a common currency, suggesting that countries that share same currency, trade far more with each other than comparable countries with different currencies (Winkler et al, 2004).

Kosovo is facing economic development issues and high unemployment. As in many other market economies, the private sector dominates the economy and it is considered the bearer of economic development and poverty reduction (OECD, 2004). Considering that the finance is important for business, the measurement of the role and the impact of chosen monetary regime in enabling the access to finance is an area of a continued research. This research attempts at measuring the impact of Euroization on Kosovo businesses access to finance, by reviewing the literature and exploring the views and experiences of economy and business experts.

1.2 Research Questions

The main aim of this research is to assess and determine the impact of Euroization on Kosovo's business access to finance. The aim will be achieved by the literature review and with the secondary data as well as with a survey containing the following questions:

Research Question 1: To what extent did Euroization provide adequate access to finance for businesses in Kosovo?

Research Question 2: To what extent did Euroization affect Kosovo's small and medium sized enterprises' access to capital?

1.3 Methodology

This research was highly based on literature reviews supplemented by the quantitative methods. A survey questionnaire was administered to a sample of 85 experts and business managers of small and medium-sized enterprises. The surveys were also provided to the public sector officials in Kosovo and to the academics in the field. Convenience sampling and snow ball techniques were prime methods of data collection. Frequency data analysis consisted of the statistical examination of survey responses and descriptive statistics were used to generally describe results of the surveyed participants.

2. Background

Recent experiences with the unilateral Euroization were seen in the Balkans, Kosovo and Montenegro. The decision was taken in order to put an end to a long period of monetary instability. The Euroization broadly helped disinflation continuously and effectively and gave the monetary systems credibility (Weber, 1991). This was also the case with the unilaterally Euroized Kosovo and Montenegro.

The Euroization system and mechanism does not entail competing between individual countries' monetary system with the monetary union. It rather entails the creation of a new currency for various reasons. Firstly, it is not actually possible to prevent one country from using the currency of another. A proposal for forcing a country to withdraw from the Eurozone and create its own currency is not enforceable. Under the Euroization system, all the country's preexisting contracts in Euro would be enforced. There is no need for the lengthy legal debate in enforcing the contract between individuals in two countries once a new currency is in place, because the Euro will continue existing in both countries (Stix, 2002).

Adopting the Euro in effect means that governments renounce monetary policy and exchange rate policy in order to adopt those conducted by the ECB, non-inflationary. Fiscal policies are more disciplined, deficits cannot be monetized. Another benefit is instant access to the capital markets of Eurozone, to governments and businesses, which significantly reduces the risk of liquidity (Philippe and Sergio, 2003). A country will need far less reserves. Indeed, they are necessary for two main reasons: to defend the exchange rate and secure payment imports and external debt. With Euroization, the first reason disappears completely, and the second is significantly reduced, as the majority of imports are denominated in Euros. Only countries that have issued debt in dollars will maintain their reserves to a certain level, which can be reduced by changing the currency denomination in their debt. The magnitude of these benefits is positively related to the degree of instability. The more unstable countries are, the higher the transaction costs are, and this country therefore benefits from Euroization. Note that the benefits of the Euroization are more important than those arising from a fixed exchange rate system; if the exchange rate risk disappears completely, the risk of failure is greatly reduced (Ritzberger, 2007).

2.1 Kosovo Economic Prospects

Laggard, unproductive and with serious imbalances: the economy of Kosovo remains an open challenge, despite ten years of assistance offered by the international community. The economy of Kosovo was one of the least developed parts of Europe. Originally the poorest province of Yugoslavia, Kosovo's troubles were added to in the nineties and that with the: poor economic policies conducted by installed Serbian administration, international sanctions, limited exports and above all, the war. The economy of Kosovo remained weak, after a peak in 2000 and 2001; it went negative in 2002 and 2003. These figures do not take into account the underground economy, however, which was estimated to be evidently widespread (Kraft, 2003). Remittances from Kosovo Diaspora (citizens living abroad) are an important source of income. Since the year 2006, Kosovo is a member of Central Europe Free Trade Agreement (CEFTA) (Ritzberger, 2007).

The economic performance of Kosovo over the last few years has actually been robust, even though the growth has been mainly tilted towards the domestic demand, fuelled by the transfers and non-debt creating the capital inflows. The large remittances from the Kosovo's citizens living abroad are boosting the consumption, whereas the foreign direct investment has fuelled activity particularly in the services sectors and in construction. In contrast, Kosovo's export sector has remained small even through regional standards, and is producing mostly low-value added products, such as base metals. Per-

Capita GDP remained low compared to the other countries of Europe (Levy, 2006). Social challenges loom large, with the unemployment estimated at more than 40% percent of the workforce, although much of this arguably reflects informal employment (Polit and Beck, 2006).

2.2 Unilateral Euroization

High Dollarization and Euroization always result from several drivers. The theoretical views have provided a basic understanding of the key drivers. Specifically, the expectations, inflation volatility, the unexpected depreciation of the domestic currency and weak institutions, all promote the domestic use of foreign currency (Beer, 2006). Moreover, the factors that relate to the financial environment can actually exacerbate the Dollarization or Euroization. In this particular regard, the Euroization or the Dollarization might appear to be a response and or a pressure to an improved entire business environment and sometimes it might have some positive impacts on the economy, including the deepening of the financial market (Feige, 2000).

Euroization may be brought about unilaterally, that is, with no approval from the European nations, and greatly includes the comparable benefits as of the complete and definite membership in the European Union. These count in much of commerce incorporation with the countries in the Euro zone, and reduced costs of transactions for the general public and trades carrying out businesses in the Euro zone. In turn, this might stimulate monetary and fiscal development and advancement, and be a focus for foreign direct investment. In addition, by means of Euroization, nations efficiently and successfully have a loan of the credibility of the European Central Bank in the context of ascertaining the stability of prices, for the reason that the Euros are anticipated to mislay their worth quite leisurely and gradually (Vachudova, 2007).

Nevertheless, the costs allied to the renouncing of the nationalized currency would also be applicable to a step on the path to Euroization. This entails the costs for the startup of actually substituting the nationalized currency and buying immense volumes of Euros for getting prepared for ebbs and flows. It has been suggested, through the experience of the induction of the Euro that this also serves as a base for the rapid stimulation of a supplementary increase of prices, with the rounding up by the businesses of the current costs and prices. More importantly, it would be impracticable to propose and put into practice an autonomous fiscal policy. The central bank, with a nationalized currency, may enhance and escalate the supply of money all through the nation, keeping in check the rates of interests, and amplifying the growth and demand. In the absence of an autonomous nationalized currency, this is not possible to be achieved, and therefore fiscal and monetary stabilization may be implemented only by means of the expenditure by the government or regime.

The debate over the unilateral Euroization that emerged by the end of 1990's has finally ebbed in the year 2000, following a very negative reaction from EU officials. It has been argued that the path that is set by the European Union will cause a renewal of the debate in the future, if the institutional path set by the EU for introducing the Euro is not modified (Kumar, 2007). Both the economic and political contexts are now radically different from the ones existing in the year 2000. The vote for the confidence in the Euro through the citizens of acceding countries is clearly described through their currency behavior. The role of Euro on the eastern and central European financial markets is also noticeable. For instance, in the countries that account for the high share of foreign exchange turnover, the Euro may actually play a so-called "vehicle" role there. It means that the Euro might be used in the exchange of two third currencies or for the exchange of the domestic currency into another regional currency (Jatras, 2006). The term Euroization implies that Euroization unites different monetary systems, using foreign currency as payment. Until the establishment of the European Monetary Union (EMU) the most widespread international reserve currency was the dollar. In the post 2002 period the Euro took over the countries of the EU and more. However, it was dependent on which currency is used as an established medium of exchange for the dollar (Dollarization) and the Euro (Euroization).

No one can accurately calculate the degree of Dollarization or Euroization. The International Monetary Fund gives the fact that approximately half of the U.S. dollars in circulation are outside the United States, while the mid-nineties First German Bundesbank estimated that foreigners hold more than 40% of the issued Deutschemark (DEM) values. The number of world currencies has been rapidly decreasing since the last decade. However, great economists in the EMU believe that there is no realistic prospect of the move toward a future world with two or three currency blocks (in addition to the Euro and the U.S. dollar, the question is what will be the world's third largest currency - Japanese yen or Chinese yuan). The Euro is increasingly becoming international currency, so that today, according to data from the International Monetary Fund, over 40 countries have exchange rate regimes linked to the Euro (Grauwe, 2005).

Official unilateral Euroization means that the foreign currency is used as a legitimate means of payment, and that there is no domestic currency. If both local and foreign currencies are used as a means of payment then the arrangement is called a partial official Euroization. Unofficial Dollarization refers to the situation where the local currency is used as a means of payment and foreign currency as a means of storing wealth. All countries that have adopted unilateral or partial Euroization previously passed the phase of unofficial Dollarization, which is usually used after the devaluation (depreciation) and hyperinflation.

Kosovo became a full Euroized country in 2002, but at this stage analysts should not underestimate the severity of EMU and its compliance criteria related to the macroeconomic discipline of the countries using the Euro. This is the biggest challenge in the transition to the Euro (Svensson, 1997). It needs guarantees of the sustainability of public finances, low inflation, stable economic growth and competitiveness. Violation of macroeconomic discipline on the part of individual countries threatens the Euro and determines the critical need for organizational improvement in the Euro area, as well as the solidarity necessary for the return of the financial stability of the country that is in trouble (Taylor, 1979). It is known that at this stage the main EMU requirement was violated by a number of countries, which has made distortions and imbalances in the whole Euro area. The financial crisis in the EMU member countries is threatened not only by further growth of the budget deficit, but also to the international liquidity position of these countries, which in turn weakens the Euro against the dollar.

The countries should be aware that in the future, candidate countries for accession to the EMU will be required to submit not only guarantees of common currency and price stability, but also to guarantee their financial stability. Changes were made in the individual EMU countries under the pressure of the crisis, forcing the EU to engage in real integration with the increased flexibility of markets in the European Union, to further strengthen the institutions, tighten the requirements for consistency and ensure the stability of the economies of the Eurozone. This means that the severity criteria for compliance with the objectives of stability will inevitably grow, not only in the foreign exchange and price, but also financially (Scanlan, 2001). Attention to the stability of public finances and thus lowering the risk of a sharp deterioration in the international liquidity position of the EMU member countries is today perceived as an important requirement to strengthen discipline in the EU. Raising the requirements and criteria of EMU could slow the accession of Kosovo to the Euro area.

The complexity of the objectives of EMU requires economic realism, and it is thought that it is the right decision to move towards EMU, but that progress towards this goal should be slowed down so as not to "beat" the decision of the fundamental economic problems of the state before the adoption of the Euro. This is further justified by a number of arguments stemming from the overly cautious stance of European structures on the final decision on the accession of Kosovo to the European Exchange Rate Mechanism (ERM II). Taking into account the need for constructive discussion, this research will focus on several key aspects of the consequences of the Kosovo economy joining the Euro area, which are important in the medium term (Ilirjani, 2006).

After the war in Kosovo, the EU adopted a new regional approach for the counties for the Western Balkans, the so-called "association and stabilization process". The aim of this approach is to protect stability and peace, and foster economic development in the region. Thus, it seeks improvement in the conditions required for the accession and integration of the Western Balkan countries into Europeans structures. European Commission in one of the recent meetings has approved the recommendation to European Council to sign the Agreement for Stabilization and Association (SAA) with Kosovo, as a first formal step of Kosovo towards the EU integration (European Commission, 2013). Kosovo has already implemented Euroization. Consequently, it must meet all the necessary criteria, and for that economic analysts must extract the important political and practical lessons from the experience of other countries and the decade of the Economic Council of the EU currency. From the financial stability point of view and the real convergence with the EU in the Kosovo economy, there are significant problems that are compounded by the current crisis. Additional adverse effects on the state budget may trigger the economic crisis that may exacerbate the problem with budget deficit and public expenditure management.

2.3 Impact of Euroization on Kosovo Economy

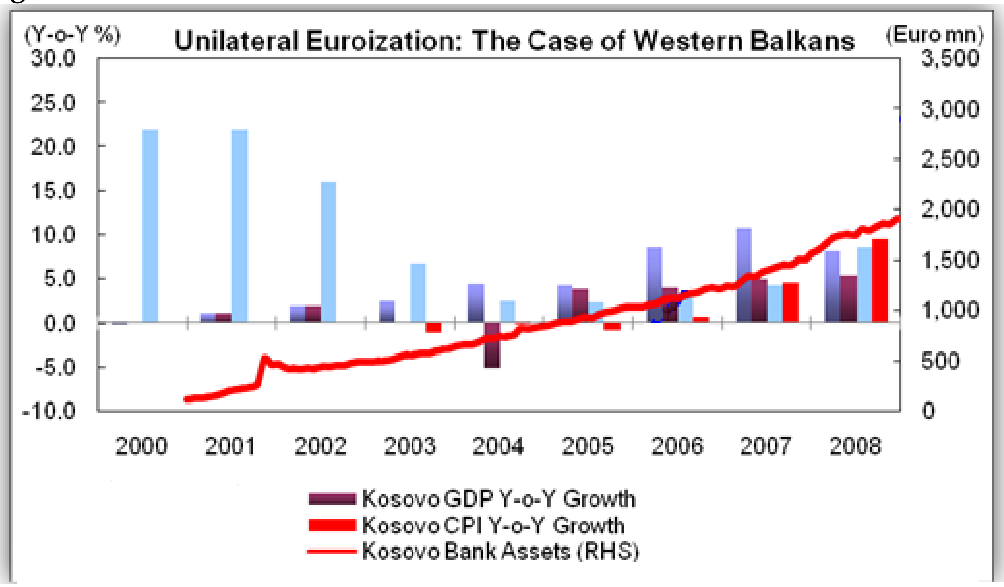
In the span of ten years, Kosovo has moved from a post-conflict country to a country that is considered in transition. It has moved away from concentrating on the reconstruction of the country toward economic development and integration into European structures. Still, the economic development is insufficient to address the challenges that Kosovo is facing, such as the high rate of unemployment, high deficit in the trade balance and the inappropriate economic structure. During 2007 for instance, Kosovo had an increase of GDP by 3.5%, but it is clear that Kosovo needs a higher degree of economic growth in order to address the challenges it faces. The trade deficit remains high, whereas exports are minor due to limited production capacities and the inability to compete with the competition. The coverage of imports with exports still remains very low, at around 10%. Based on the statistics of 2005, most of the companies registered in Kosovo were concentrated in the trade/services sector (about 50% of all companies), transport and communication (10-14%), hotels and restaurants (8-10%), and construction (4-5%). The participation of production enterprises in the general number of registered enterprises was between 8% and 9%. Unemployment rates vary from about 30% (IMF, 2004) to about 45% in 2009 (SOK, 2010). The largest participators in the labor market in Kosovo, over 40%, are youths between the ages of 16-24. About 28,000 new employment seekers enter the labor market on a yearly basis (Tanaka, 2007).

Economic integration of the world by means of exchanged goods and services, licenses and knowledge, export of capital and economic-technical as well as financial cooperation represents one of the main characteristics of the modern economy. All EU member states, within the framework of this cooperation, have achieved considerable results and have benefited in every area of life. Therefore, economic interest should serve as the key incentive for countries of Western Europe, Central Europe, and Southeast Europe as well as the Balkan countries, which would bring benefits for all those that cooperate, also Kosovo, as part of the Balkans which aims to become part of the EU.

The abandonment of the national currency and adaptation of another currency, in the case of Europe, the Euro, is not a process that has taken place without the feeling of having lost sovereignty by each state separately in the process of handing over this attribute to Europe. The beginning of 2009 marked the 10th anniversary of the Euro, the currency that allowed accession of the economic and financial policies of hundreds of millions of Europeans. The countries that have the Euro now enjoy a larger and safer market with less risk of devaluation and inflation. The Euro currently represents the largest currency in Europe and it is among the strongest currencies in the world. The Euro provided Kosovo with a stable monetary environment; it also alleviated economic transactions with key Kosovo trade partners (Trbovich, 2008).

However, it also provided a cost for the Kosovo economy, such as the loss of seigniorage income and the loss of sovereignty over the monetary policy. However, the costs may be considered acceptable compared to the advantages that were brought to the Kosovo economy by the introduction of Euro. Furthermore, under the unilateral Euroization, the Kosovo economy has experienced growth acceleration from the year 2004. In addition to this, the currency stability also contributed in the growth of banking industry, moreover, it lead to an increase in the banking asset that was twice as much as it was before implementing unilateral Euroization. Kosovo has experienced an immense growth in the economy as a result of reduced transaction costs and an upsurge of foreign trade (Hammond, 2009). It can be further illustrated by the following figure 1 about the positive impact that Euroization had in the overall GDP growth, Consumer Price Index (CPI) and increase in banks assets.

Figure 1: Western Balkans Euroization



Source: Hammond, 2009

The monetary union, just like the European Monetary Union, needs to establish a procedure as a tool for coping with the debt default. The ten-year participation of Kosovo into Euroization allows conclusions to be drawn on how the Kosovo economy has adapted to the integration process in order to move towards sustainable socio-economic development and the achievement of the criteria for participation in a higher form of integration - the Economic Monetary Union (EMU). The current integration process, however, coincides with the global financial and economic crisis. The depth of the crisis and its rapid proliferation is because of the financial interdependence of national and international markets. It has impacted strongly both on individual EU countries and economic integration of the European Union as a whole. The fundamental effect of medium aggregate factors of the global crisis, of course, creates a hostile environment in the external economic conjuncture, and this affects the developing Kosovo economy during the period (ECB, 2007).

For countries/territories officially Euroized, for Kosovo and Montenegro, Euroization has contributed to macroeconomic stabilization, characterized by a very rapid deflation at the start of the process. Its effects on growth are less obvious to identify due to external factors, such as fluctuations in the external amounts, which represents a large share of GDP in the country of Kosovo. Provided with the very high deficit in their current accounts, the foreign exchange reserves of these countries/territories are practically nil. In addition, both depend heavily on external sources for the financing of the current account deficit, such as tourism revenues, public assistance or external transfers from migrant workers, which feed foreign currency deposits. Kosovo has not had the sovereign status of Montenegro until recently; moreover it did not have access to international capital markets. With the Euroization the situation has become considerably different, compared to the earlier economy of the country, despite that Euroization did not enable Kosovo to gain all the benefits of the European financial system.

Euroization should provide the economy with more stable interest rates and exchange rates as the fiscal policies are more disciplined as deficits cannot be monetized. For some countries of the CEE, such as Albania, Bulgaria and Romania, this advantage is very substantial, ahead of the widely micro-economic benefits of Euroization. Another gain is instant access to the capital markets of Euro zone, such as governments and businesses, which significantly reduces the risk of liquidity. In the context of Kosovo, Euroization has also its costs, which however, compared to benefits are still to be considered fewer.

2.4 Business sector development

The Business Development plays a vital role in increasing revenue, customer loyalty, and overall objectives of the company. All organizations are struggling to build a business organization, efficiently penetrate new markets and attract new customers. Modern businesses are faced with many challenges in their current business undertakings and need to fight for their survival as global events and competition affects them either positively or negatively. Business environments keep changing as businesses strive to maintain their market share and at the same time provide quality services to their customers. The term 'business environment' refers to both the internal and external factors that may impact upon the growth and overall performance of the organization (Worthington, 2009). Modern businesses are forced to build economic and political connections that usually involve the transfer of funds, goods, and people across state boundaries.

Structure and the shape of business in Kosovo, as well as in other spheres of life, were determined by the context after the 1999 war. UNMIK administration established initially the trade and fiscal policies of Kosovo. Since Kosovo was depended on the dominant part by the imported goods, fiscal and tariff policies in relation to other countries had an impact on the structure and the flow of goods in external trade. Invoking the legal constraints and past circumstances, different tariffs for trade with neighboring countries of Kosovo were established. In relation to Serbia and Montenegro, the import duties were 0%; 1% with Macedonia while 10% with Albania and other countries. Though, this policy was changed with the signing of the CEFTA in 2006 (CEFTA, 2013) where trade tariffs were taken off amongst signing countries.

Kosovo market in one hand was in deep need of emergency supplies while essential products demand was high. In addition to freight revenues as donations from domestic and international organizations, trade sector found greater space for action. Revenue from donations of International Organizations, the employees in these organizations, constituted abroad-based consumption. Also the revenues that came from migrant remittances were a source of daily consumption of households returned to Kosovo after the mass exodus from war. As a result, the private trade sector of the economy dominated the number of businesses and as presented in the table 1, such a structure is still present even in recent years. It includes the newly established businesses as well as the once that were privatized.

Table 1: Number of Businesses According to Economic Activities 2005–2010

Description	2005	2006	2007	2008	2009	2010
Mining	144	152	154	207	200	205
Industry	3.914	3.698	3.794	4,313	4,353	4,356
Productions, distribution of electricity, gas and water	13	17	18	50	56	68
Construction	1.894	1.648	1.658	2,297	2,390	2,474
Wholesale and retail trade, repair of vehicles and household equipment	20.281	18.985	22.185	20,795	21,105	19,755
Hotel and restaurants	3.226	2.990	3.325	3,498	3,559	3,364
Transport, post and telecommunications	3.676	3.110	3.185	3,610	3,655	3,377
Businesses services	1.297	1.330	1.430	3,846	4,197	4,112
Other services	2.180	2.095	2.090	2,501	2,564	3,345
TOTAL	36.625	34.025	37.839	41.117	42.079	41.056

Source: SOK, 2013

From the total of 41,056 active enterprises in 2010, over 19,700 belong to the trade sector while 4,356 industry sector, followed by the hotels, restaurants and transport and telecoms with 3,377 enterprises. In relative terms, trade counts with 48.1%, industry 10.6% and hospitality and tourism with 8.1%. The applied policy defined the economic structure but also the beginnings of the post war economic relations with other countries. Compared within the previous years, the enterprises in trade sector have shown a decrease trend while a symbolic increase in industry and production enterprises.

2.4.1 Sources of finance for SMEs

The role of small and medium businesses as a driving force of economic development, job creation, and poverty reduction in most developing countries is evident. For this sector, access to favorable finance is foreseen as one of the major determinants of its growth. External finance is foreseen as one of the major determinants in small business growth. This conclusion is derived from Okpara and Wynn (2007), who grouped categories of small business problems into four: administrative (accounting, finance, personnel and management issues); operating problems (marketing, inventory control, production and operations); strategic problems (planning, market research and financial analyses); and external problems (infrastructure issues, corruption, technology and low demand). Amongst all limiting factors of growth, access to favorable finance leads the list of problems of such businesses in Nigeria. This also seems to be the case in other countries (Okpara and Wynn, 2007). Peter Harder (n.d) listed three factors in business formation and development in Germany prior to the industrialized period, those being the governmental economic policies, financial institutions and business organizations, and the disadvantages of backwardness. As far as financial institutions are concerned Harder highlighted the problem of underdeveloped financial institutions and capital procurement (Harder, n.d).

As for the financing alternatives, Abdulsaleh and Worthington (2013) have identified the sources of SMEs finance used in all phases of the enterprise development. The list is summarized in the table 2 below. The table also contains a column that determines the availability of each source in Kosovo, derived by the researcher based on various sources.

Table 2: Sources of SMEs Finance

	Description	Available in Kosovo
Equity Financing	Owner/managers personal savings and internally generated profits	Yes
Venture Capital	Funds raised through financial intermediaries	Limited scope (lack of capital market development)
Business Angels	Informal "market" for direct finance to businesses	Yes (perception)
Debt financing	Debt financing vs. equity to keep full ownership of business	Yes
Trade Credit	Delay in the payment of goods and services after they have been delivered	Yes
Nonbank Financial Institution Debt	Credit unions, pension funds, finance houses, investment trust companies, insurance companies ect.	Limited (not to say non-existent)
Bank Finance for SMEs	Main external finance provider	Yes
Government Assistance and Initiatives	Credit guarantee loans, factoring programs, subsidized fees	Limited (applied mostly in agriculture sector)
Islamic Finance for SMEs	Considered sell suited to finance SMEs	No (legal base recently established)
- Musharakah	Forms of partnership to share profits	
- Murabaha	The financier purchases goods ordered by the client and resells to the entrepreneur with a negotiated margin	
- Mudarabah	Profit sharing and loss absorbing (capital provider)	

Source: Abdulsaleh and Worthington (2013)

2.5 Financial Sector Development

Kosovo's financial sector, which is being supported by the Euroization, was created from scratch after the end of the conflict. Instead of banks or any other financial institutions, transactions were always dealt in cash. For almost about two years after the conflict there were no institutions that would help the citizens in their financial matters except for one, which was called the Micro Enterprise Bank (MEB) and specialized in micro credit (Ritzberger, 2007).

The seven commercial banks in Kosovo expanded significantly in the years 2004-2005. The financial system has always been significantly characterized by the participation of foreign countries, due to Kosovo's small economy and population, as well as a previously bad experience with banks. The majority of shareholders in Kosovo's commercial banks consisted of the European banks so that they would have high leverage in case of bailouts. An example is that the American bank of Kosovo was sold in the early 2003 to Austria Raffeisen Bank (Ritzberger, 2007). According the CBK (2013) as shown in the table 3 below, currently, the financial sector is dominated by the nine (9) commercial banks and thirteen (13) insurance companies, followed by other funds, micro finance and intermediary institutions.

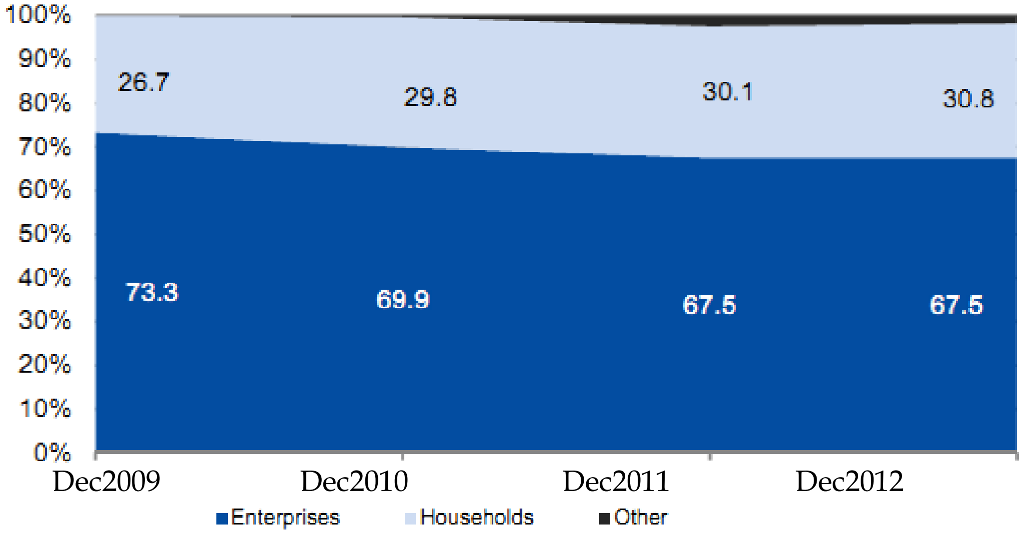
Table 3: Banks, Insurance Companies and Pension Funds 2009 – 2012

Description	2009	2010	2011	2012
Banks		8	8	9
Insurance companies	11	12	13	13
Obligatory and individual funds	2	2	2	2
Microfinance institutions				18
Auxiliaries	-	-	-	38

Source: CBK (2013)

The value of the total financial sector assets reached € 3.8 billion in 2012, representing a growth of nearly 10% compared to 2011. With a 56.3% share in country's GDP, the banking sector dominates the share of the financial asseets with around 74% (€ 2.83 billion), followed by the pension funds with around 19% and microfinance and other intermediaries. As for the credit potencial, loans dominate the structure of the banking sector assests by 62.3%, with a total amount of €1.76 billion. Loans given to enterprises, at around 70%, formed the major share of the loans structure in the previous years (see figure 2 below). A considerable amount of the Kosovo's financial assest remain invested in the foreign market. In 2012 this amount reached €2.34 billion, around 61% of the total (CBK, 2012).

Figure 2: Structure of loans



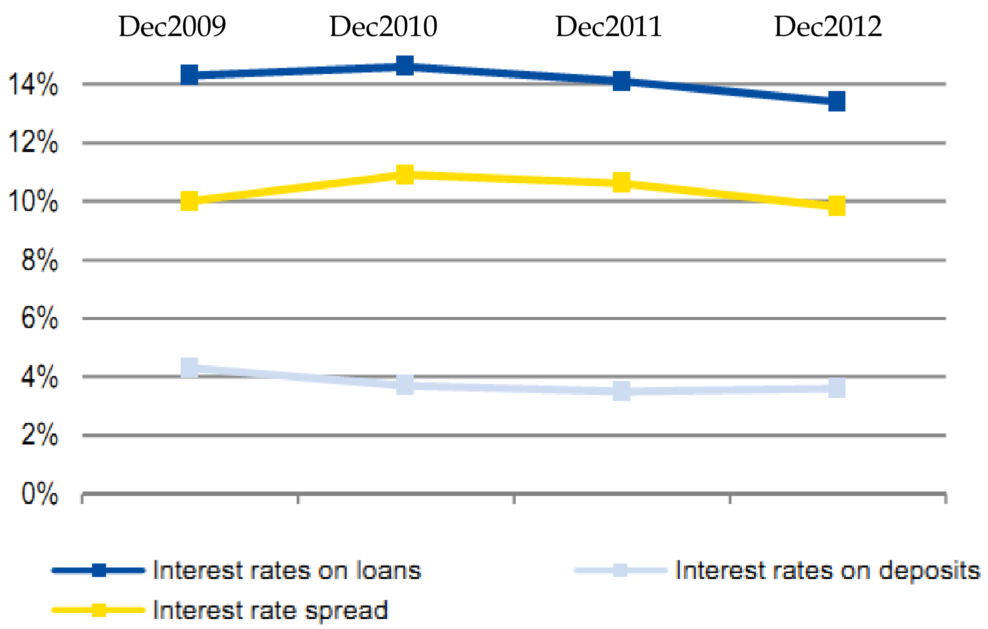
Source: CBK, 2013

The structure of loans given to businesses, by economic activity, represent more than less the structure of business sector in Kosovo. Around 50% of credits were given to trade sector enterprises; mining and extractive sector about 20% while production was about 15-18% (CBK, 2012).

As the financing is dominant in loans by banks, the source of finance and its cost remains a challenge for businesses. With the lack of capital market development, Kosovo remains with the highest interest rates on loans in the region. Euroization in Kosovo has been expected to lower the interest rates, i.e. equalization of high interest rates with world interest rates and the interest rates of the European Monetary Union. High interest rates are the result of restrictive monetary policies, because the process of unilateral Euroization is usually included in the state of hyperinflationary conditions and increases the risk of the state. The risk of interest rate consists of two components: currency risk and risk of default in financial obligations. In Euroization, the currency risk is reduced to zero, which reduces the risk premium and has a positive impact on the fiscal and economic performance of the country. In addition to reducing interest rates, it is less likely that there will be equalization of interest rates with world interest rates, because of the potential budget deficit, development of the financial system and the legal system and the labor market. Interest always contains the risks of the state, which is determined by the level of credibility

(Ilirjani, 2005). As shown in the figure 3 below, interest rates on loans were about 14% while on deposits around 4%, in previous years.

Figure 3: Annual average interest rates



Source: CBK (2013)

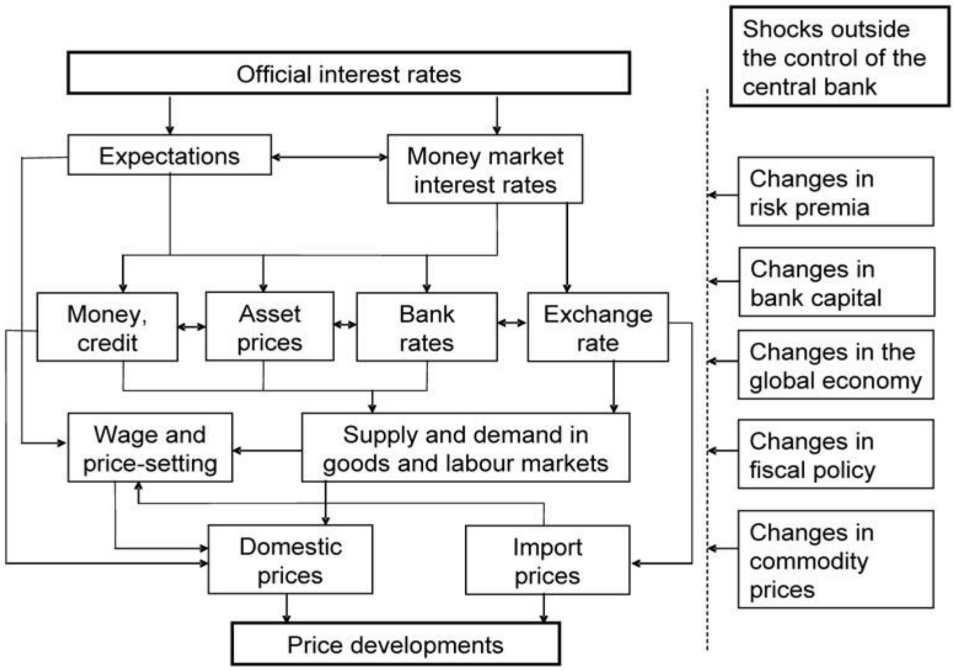
2.6 Determinants of interest rates

Interest represents the cost of borrowing money. The nominal interest rates offered in markets is the total of several components. Principally, an interest rate is established based on such a several components, mainly profit and risk based: the real rate of interest; inflation premium; risk premiums such as default risk, liquidity risk premium and the maturity risk premium (Gallagher and Andrew, n.d).

Deposits collected internally form the major part of credit potential in Kosovo banks. If we take the given indicators from the figure 3 above, it is seen that the cost of deposits, which would form the real interest rate on loans in 2012 was about 4%. The rest of premiums percentage of 10%, making the interest spread comprises the profit and risk premiums. Currently, it is believed that default risk comprises the main portion of the premiums in forming the overall interest rate of around 13.4%. The allocation of percentages to different component premiums is considered an internal business matter of the banks.

The transmission mechanism of the ECBs monetary policy (see figure 4 below) affects the economy in general and particularly the prices. The effectiveness of the transmission mechanism, with the focus on credits and interest rates pass-through, remains a continued debate within the EU countries. In the case of Romania, for instance, a study conducted by Murarshu revealed that interest pass-through is not complete and the degree of interest rate pass-through is bigger for interest rates charged on loans than for interest rates paid for deposits. Also, the spread associated to the lending activity is consistently bigger than the spread of the deposit taking activity. The mean adjustment lag at which market interest rates are fully passed through to both loans and deposits interest rates is found to be almost 3 months (Murarshu, n.d).

Figure 4:ECB main transmission channels of monetary policy decisions



Source: ECB, 2013

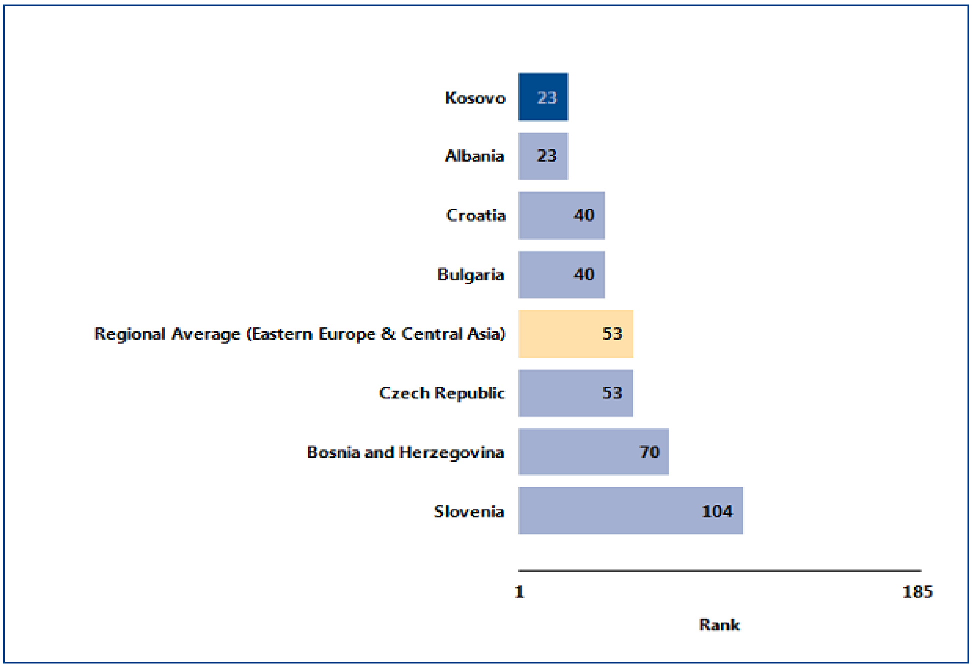
Amongst other areas, the monetary policy decisions affect: ***banks and money-market interest rates***, the changes in the official interest rates will directly affect money-market interest rates and, indirectly, lending and deposit rates, which are set by banks to their customers. It also affects the ***supply of credit***, in such a way that higher interest rates would increase the risk of borrowers being unable to pay back their loans. Banks may act by cutting back on the amount of funds they lend to households and firms which than also reduce the consumption and investments. Further, it affects the ***supply of bank loans*** by affecting their marginal costs for external finance (ECB, 2013).

The Euroization system broadly has contributed in reducing interest rates in member countries. The ECB's monetary instruments can impact the lending costs by setting the real interest rates on financing instruments. The transmission mechanism within the Euro system is aimed at reaching with efficiency the intended impacts in the member countries economy. It has shown different dynamics and speed in reaching different countries alike. The interest rates pass through mechanism in the case of unilateral Euroization of Kosovo, does not have any direct effect (ECB, 2000). Whatever the interest rates of the ECB would be, the interest rates on the main refinancing operations and on the standing facilities, the impact in Kosovo economy is hardly noticed. This was easily evidenced in recent financial crises in the Eurozone, which resulted with the reduction of interest rates by ECB at the lowest and with the introduction of the "non-standard" policy measures, since mid-2007, such as the provision of funding to the banking system via its long-term full allotment liquidity operations and the purchase of euro-denominated covered bonds (ECB, 2009), while the rates in the banking sector of Kosovo remained at an unchangeable level. The positive impact of ECBs measures in maintaining the trust in the currency is not to be neglected, however.

2.7 Business access to credit

Easiness in getting credit is a precondition for enterprises to potentially establish and expand. In this regard, different research and publications have presented contradictory data, depending on the approach of their study. According to the World Bank, Kosovo stands high compared to regional and other countries for ease of credit getting. It was ranked 23rd in the ranking of 185 economies of the world, by Doing Business report (2013), shown in figure 5 below. The comparison amongst countries is designed based on two main indicators, which undoubtedly facilitate the access to credit: credit information system and adequate collateral and bankruptcy laws.

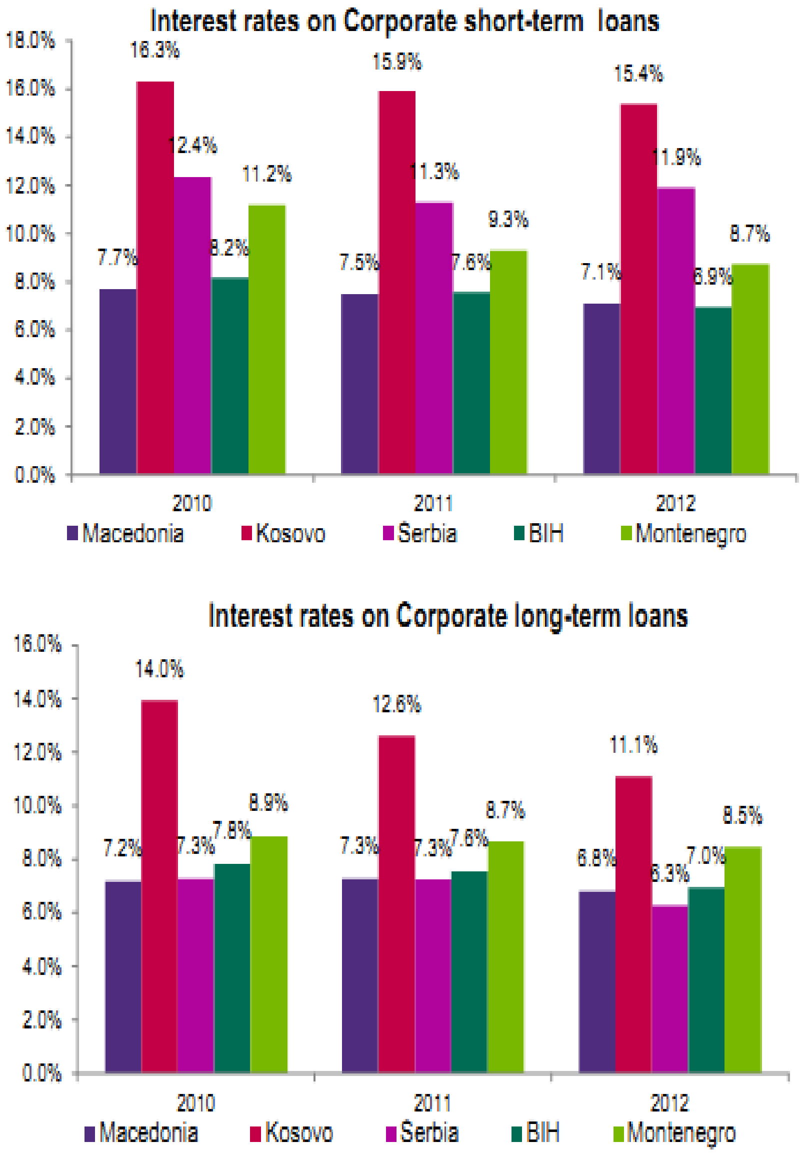
Figure 5: How Kosovo and comparing economies rank on the ease of getting credit



Source: WB Doing Business, Kosovo (2013)

The criterias established in the Doing Business report, represent an institutional development aspect, which also carries a high importance. However, the easy access to credit and finance for businesses is just "one side of the coin". To form a better view on the situation, along with the ease to access credit, the question as to what kind of credit is available for businesses in market, deserves some attention. In this respect, the quality of finance concerning favorable credits to businesses is a key matter. For instance, as far as interest rates applied to companies, Kosovo stands much higher compared to regional countries (see figure 6 below). Even though a positive trend in lowering interest rates is visible, it still stands at above 11%, according to a study of the Banking Association of Kosovo (BAK) (Ali, 2013).

Figure 6: Interest rates on loans



Source: Ali (2013)

In conclusion, the author provides a list of factors that affect the business environment of the Kosovo's banking sector, such as: overall macroeconomic conditions; political instability of the region; credit non-rating of Kosovo; environment for doing business; rule of law and investors protection; high level of informal economy; level of non-performing loans; degree of bank risk management, size of bank transactions, interest rate elasticity and interest rate variability and absence of government subsidies for the sector, amongst them (Ali, 2013). However, it seems hard to measure the scale of impact each factor has in the conditions of finance offered to businesses. Prior to this study, the lack of political status resolution was considered one of the main risk factors for Kosovo, which presumably impacted the cost of credits. However, despite the status resolution, interest rates remained considerably high compared to regional countries and Europe, though some trends towards a slow decrease are evident. Interest rates spread remains also high. The figure 4 below shows the trend in interest rates spread. During the period of 2010 – 2012 the interest rate spread was about 10% which determined the average interest of loans, at as high as around 14% (CBK, 2012) and which is much higher than other regional countries.

Table 4: Interest rate spread comparison

Interest rate spread	Macedonia		Kosovo	Albania		Serbia		Bosnia and Herzegovina	Montenegro
Currency	Denars	Euro	Euro	Euro	Lek	Dinar	Euro	BAM	Euro
2010	2.50%	4.30%	10.90%	7.39%	4.89%	N/A	N/A	N/A	5.70%
2011	2.90%	4.70%	10.00%	7.00%	5.00%	6.91%	2.64%	N/A	5.81%
2012	3.40%	4.80%	9.20%	6.35%	4.50%	6.75%	2.26%	N/A	5.59%

Source: Ali. (2013)

A local research institute, Forum 2015 and Riinvest, also conducted a research about the banking sector development and as far as access to businesses for SMEs concerned, a survey with 600 SMEs revealed that cost of financing and access to finance were the main obstacles in doing business in Kosovo (Aliu, et al. n.d). Access to finance constitutes the major problem for business development and the financing conditions are more difficult for SMEs than for the larger companies of former socialist countries that accessed the EU (Volz, 2004). Access to finance and the capital markets for SMEs has also been difficult, not only in Kosovo (Toçi and Tyrbedari, 2005). In one of his papers, Basu (1989) proves this for Australian companies as such (Basu, 1989).

3. Data Presentation and Discussion

This section of the research work represents the data obtained from the survey questionnaire, which was obtained from the respondents belonging to diverse backgrounds. The analysis has been represented quantitatively in frequency charts and percentages.

Research Question 1: To what extent did Euroization provide adequate access to finance for businesses in Kosovo? The table 5 below shows the survey results:

Table 5: Question 1: Has Euroization Provided Adequate Access to Finance for Businesses in Kosovo?

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly Agree	27	32	32	32
	Agree	23	27	27	59
	Neutral	17	20	20	79
	Disagree	15	18	18	96
	Strongly Disagree	3	4	4	100
	Total	85	100	100	

Source: Author's own calculations

From question 1, the responses obtained from the respondents were quite positive. 27% of the respondents strongly agreed with the statement and argued that Euroization has actually delivered a path for businesses to access finance in Kosovo, whereas 23% of the respondents agreed with the same statement. Foreign businesses are being attracted towards investing in Kosovo markets and diverse industries.

The experience of Kosovo with Euroization has proven that along with the ease of access to finance for business, the favorable finance is what matters. Loans and finance components such as interest rates, grace periods applied and the diversity of finances matters a lot. In these aspects Kosovo remains still behind, even the regional countries also. Moreover, the lack of structural integration with the EU, the unilateral Euroization has not secured access to European financial markets and Kosovo still lacks the capital market development and access.

Research Question 2: To what extent did Euroization affect Kosovo's small and medium sized enterprises' access to capital? The question 2 of the survey was: Has Euroization had an impact on Kosovo's small and medium sized enterprises' access to capital? Table 6 below shows survey results:

Table 6: Question 2 - Has Euroization had an Impact on Kosovo's Small and Medium Sized Enterprises' Access to Capital?

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly Agree	32	38	38	38
	Agree	20	24	24	61
	Neutral	16	19	19	80
	Disagree	12	14	14	94
	Strongly Disagree	5	6	6	100
	Total	85	100	100	

Source: Author's own calculations

The above table demonstrates the responses from the respondents regarding the influence of Euroization on the access to capital of small and medium sized enterprises. Most of the respondents responded in a manner by strongly agreeing with the statement. 38% of the respondents strongly agreed with the fact; however, 24% of the respondents just agreed with the fact. 14 % of the people disagreed with the statement that small and medium sized companies have got access to capital with the Euroization in Kosovo.

However, in the private sector of Kosovo, only 2% of businesses are classified as small and medium-sized enterprises. The ones that are employing more than 250 people in large companies form less than 1% of all businesses. Medium-sized and large companies, however, form a surprisingly large proportion of employment, which together employ more than a third of private sector workers. Kosovo's micro enterprises are often a one or two-man businesses, which are created by the necessity to get some income. Almost half of the micro-business owners have been unemployed before joining the business. It has been revealed that these kinds of companies would not normally be able to expand; though they are important sources of employment their overall role in economic development is not significant. The majority of these companies provide services in Kosovo, and only 2% of them are involved with primary production, such as agriculture. Companies within the industry are 16%. The agricultural sector of the country is quite attractive, because agriculture is a major employer. This signals that a significant proportion of companies operate in an informal basis.

The policies in Kosovo seemed to favor the businesses that remain in small-scale. The key problem is the regulatory control randomness. Micro businesses are not much enforced and can easily stay within the scope of the underground economy, but the bigger the company gets, the more closely it becomes controlled. Tax policy favored small companies anyway. Less than 50,000 Euro turnovers for example do not need to be subjected to value added tax. On the other hand, fiscal policy has also enhanced the business climate. For example, in 2009, capital gains tax was halved. However, the impact of the informal sector reduces the net expected results in revenues. The larger companies do not emerge because, amongst other, an important issue is the lack of capital and the difficulties in obtaining loans at reasonable conditions and favorable interest rates.

Kosovo does not have access to capital markets of EU and its businesses lack this possibility. Moreover, Kosovo has not yet developed the secondary capital market through which companies may raise funds and trade their shares. With this in mind, the banking sector was the only source of accumulating liquidity for necessary business loans and finances, which so far were characterized by high interest rates and short or almost no grace periods. Euroization in Kosovo has the usual benefits of a monetary union. The transaction costs for trade, investment and services are reduced. The information costs reduce economic transactions. Risk premiums disappear. Default risks persist but become very weak. Frankel (1999) reported that the risk of failure is not independent of the exchange rate risk. If investors expect a devaluation (currency risk), they anticipate that domestic banks, businesses and the government will find it harder to meet their external debts after the devaluation (risk of failure). Therefore, if the exchange rate risk disappears, the risk of failure decreases substantially, thus giving an impetus to trade, investment and growth. The other advantage is that Euroization brings macroeconomic stabilization and strengthens credibility. Adopting the Euro in effect means that governments renounce monetary policy and exchange rate policy to adopt those conducted by the ECB, supposedly non-inflationary.

4. Conclusion

The analyses of the literature and the survey questionnaires resulted with a significant impact of Euroization in business access to finance in Kosovo. On the core issue of businesses' easiness to access finance the analyses of the data showed that there are ample chances for the business development by utilizing Euroization. The Euroization has impacted positively the overall macroeconomic stability and financial sector development, which was the main source of business development. However, the easiness in getting credit proved an insufficient incentive for businesses to borrow and grow. The cost of capital and various sources of finance is what also matters. On the side of the conditions of business finance and the sources of finance, the need to improve is necessary and the room for improvement remains wide, in order for Kosovo to raise its business competitiveness and in reaching the regional countries.

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