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## Transforming the Institutions of Finance

Business growth is the root of a healthy economy. It fosters employment and job opportunities and stimulates commerce. However, when there exists no means for investing or borrowing money, even basic business practices are thwarted.

This is the impasse that Kosovo businesses faced following the violence and repression of the 1990's. By 1999, the banking system of Kosovo was completely destroyed. There was no financial intermediation and virtually all transactions were settled in cash. International money transfers were unavailable; private business credit was non-existent. The financial sector suffered from a decade of mismanagement and total loss of public confidence.

Setting out on an ambitious Economic Program, USAID sought to revitalize the Kosovo economy by turning its attention to the financing of small and medium sized enterprises (SMEs) and by creating a healthy regulatory framework for the financial environment that supports the existence and effectiveness of Kosovar institutions.



The Banking and Payments Authority of Kosovo.  
Serving as Kosovo's central bank.

### *BUILDING A SYSTEM: THE BANKING AND PAYMENTS AUTHORITY OF KOSOVO*

In 1999, there was no trace of a financial institution in Kosovo. The only hope of reinstating public confidence in banking and other financial structures was to eliminate all shadows of previous systems. Kosovo needed sound guidelines. Thus, for USAID, an immediate priority was to begin establishing a regulatory framework for the financial sector.

Now, four years later, with USAID assistance, Kosovo's financial sector has been overhauled and recreated. Success is evident and public confidence in banking has soared. Deposits are growing and small but healthy loan portfolios have been established. In addition, insurance institutions are now under regulation, and the implementation of a comprehensive pension system is underway.

In November 1999 the Banking and Payments Authority of Kosovo (BPK) was established by UNMIK, to oversee the creation of basic regulatory, organizational and technical infrastructure needed for a competitive financial system. Given the complete lack of banks and commercial banking services, BPK was tasked with operating a wide network of bank branches serving all communities. Concurrently, with USAID support, BPK developed and implemented a stringent bank licensing system with tight financial reporting and performance requirements.

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Legislation was upgraded to improve standards for all financial institutions' operations including micro-credit organizations.

Gradually, the banking system accumulated some significant assets. Additionally, with USAID assistance in the transition from the deutschmark to the euro in early 2002, a large amount of cash was taken out of circulation, thereby greatly increasing bank deposit levels.

After sufficient development BPK was able to divest itself from the branch network by leasing its branches to existing banks, thereby ceasing its commercial banking services in 2002. With a bit of organizational restructuring BPK was now in the position to undertake responsibilities as banker to and fiscal agent of the anticipated Kosovo Administration, represented by the Provisional Institutions of Self Governance (PISG). By this time BPK had also further expanded its financial sector supervision and licensing responsibilities and had begun to develop the Insurance and Pension sectors.

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*Success is evident and public confidence in banking has soared.*

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Focusing on the insurance and pension sectors, USAID helped the BKP develop and implement sound regulatory requirements for both. A rigorous licensing, financial reporting and oversight system was established for a nascent but active insurance industry that had been functioning in an improper environment. In 1999, there was no legal framework and no supervision. With the assistance of Bearing Point advisors, a comprehensive insurance regulation was put in place that was consistent with international best practices; implementing rules and procedures were established; and a regulatory oversight unit was staffed and trained within the BPK. In support of a pension program, BPK regulates the administration of the 2nd and 3rd tier of a three tiered pension reform program. The program as a whole has the potential to develop into a state-of-art pension system.

The effective formation and operation of these institutions, combined with ongoing training, will eventually put management entirely in the hands of Kosovar professionals. After years of disarray and failure, Kosovo's financial sector, with the guidance of BPK, is rightly placed to emerge onto a path of stable long-term growth. ☘

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## THE AMERICAN BANK OF KOSOVO: CREDITING KOSOVARS



As the crisis came to an end, Kosovars citizens and business owners struggled to get on with their lives and reestablish their businesses. But they faced a tough reality. In addition to the general devastation of assets and property, there was no access to capital or modern banking services with which they could begin building a future. Insufficient credit existed to support the recovery of private enterprises. Business growth was shackled, the very engine of economic growth and employment.

In response to these issues Deloitte Touche Tohmatsu (DTT) was chosen to implement the Kosovo Business Finance Project, a component of USAID/Kosovo's Employment Generation Program. This initiative would provide financing to SMEs and would establish a full-service commercial bank with capable local bank professionals to sustain it. The goal - to create sustainable private sector employment by supporting investment in and expansion of privately owned Kosovar businesses. In June 2001 the Kosovo Business Finance Fund (KBFF), a local NGO, was born - a quick-response facility providing lending and credit to SMEs. There now existed a way for business owners to formally receive loans and build credit, something that previously did not exist.

November 2001 saw the creation of the American Bank of Kosovo (ABK); an institution operating with the goal of providing competitive banking services throughout Kosovo and continuing SME credit distribution. By June 2002 the KBFF foundation had succeeded in establishing a locally-staffed credit operation, and had reached its ambitious goals of training local credit department staff, disbursing \$5 million of donor (USAID) funds as SME loans, maintaining less than 4% delinquency on loan repayments and creating 1,000 new jobs in the first 9-months. It was at this point that the foundation merged its operations into ABK; thereby becoming the Bank's credit department, as well as its major shareholder. The American Bank of Kosovo was now an operational full-service financial institution, managed and operated primarily by Kosovo citizens, and licensed as a Joint Stock Company. With ever-increasing consumer confidence, the bank soon saw a dramatic increase in deposits and loans, and became the first bank serving several minority areas of Kosovo.



In December 2002, Raiffeisen Zentralbank Österreich AG of Austria (RZB), through its investment arm, purchased 76% of the capital stock of the American Bank of Kosovo. Then in July 2003, the final 24% shares were sold to RZB. Appropriately, the name of the Bank became Raiffeisen Bank Kosovo.

The purchase of the American Bank of Kosovo represented the largest private sector post-war investment in Kosovo to date. The transformation of this USAID-funded project to a privatized, sustainable commercial business was a significant achievement that will continue to create jobs and provide lending to support the Kosovo economy. Proceeds from the sale will be used to finance further development of the private sector. ☘



## BUILDING CREDIT TO BUILD A BUSINESS

Bajram Abdullahu and Sylejman Topanica spoke confidently and proudly under the looming presence of a twenty-foot high piece of manufacturing equipment that makes plastic bags and sheeting. Since 1986, these two long-time friends have run BAST, a plastics manufacturing business in downtown Pristina.

"We started very small and have achieved a lot," says Abdullahu.

When BAST started, business practices in Kosovo were a very different affair. Business owners in the 1980's had no formal means of getting financing through banking institutions. The only hope was to know someone who had the excess cash on hand, and was willing to lend it based on a condition of mutual trust and honor, which sealed the payback agreement.

So when Abdullahu and Topanica decided to go into business together this was the only way they could finance their small start-up, by using the money of someone who trusted them. With this, they purchased a single piece of equipment from Germany, and opened BAST, a manufacturer of small plastic bottles.



Plastic bottles that Bajram Abdullahu (left) and Sylejman Topanica (right) are producing and selling.

Since the 80's, their friendship has come a long way, and so has BAST. It has become the largest company of its type in Kosovo producing a vast variety of polyethylene products. Through smart business decisions and establishment of a formal credit standing with the American Bank of Kosovo (now Raiffeisen Bank), the co-owners of BAST seem to have a bright future ahead.

For years, U.S. citizens have been taught the value of building a solid credit history to upgrade businesses, buy homes, and finance education. However, in Kosovo there was no such access to capital. When the KBFF was established in 2001, its purpose was to help small business owners like Abdullahu and Topanica. It was a blessing for BAST business and its founders.

Signing a tough one-year loan agreement with the Kosovo Business Finance Fund they covered 80% of the equipment costs. The machinery paid for itself, and the loan was repaid on time. By 2002 the partners had submitted another application for financing. Now, through financing the expansion of their product line, their sales have increased by 30%, as has their number of employees.

"In order to exist, you always have to invest in something," says Abdullahu, as his co-owner nods his head in agreement. Many Kosovars are hesitant to borrow money for a variety of reasons. Historically banks have not been a trusted and reliable business resource in the region, and interest rates and tight repayment plans can be difficult to justify. But the BAST owners understand very well the responsibilities related to borrowing money and the benefits of investing in their operations.

They also understand the value of staying on top of new developments and opportunities by regularly attend seminars and pay close attention to consumer trends and the economy, updating their equipment and product lines accordingly. "The small one is not eaten buy the big one; the slow one is eaten by the fast one," quotes Topanica.

As good credit customers should, Abdullahu and Topanica have been promised full support from Raiffeisen Bank with investments in the future. ☘

## ON TOP OF THE INSURANCE INDUSTRY

From a large corner office in downtown Pristina, Hashim Rexhepi is extremely busy overseeing the Insurance Supervision and Licensing Department of the BPK and its 13 staff. Hired as Director, in April 2003, Rexhepi never dreamed that he could have such a prominent management position in a job that wasn't influenced by politics.

As the President of a highly politicized youth organization in the 1980's, Rexhepi is no stranger to political agenda in the work environment. But when he was hired as the Deputy Director of the Statistical Office of Kosovo in 1990, the harsh realities became even clearer. Similar to the fate of many professionals in Kosovo, after 4 months Rexhepi was told that his job was ending. Why? - because he was Albanian.

But by the time the crisis ended Rexhepi had put some private sector experience under his belt by operating his own commerce business and then running a local insurance company, managing its brokers and agents.

In 1999 Rexhepi was rehired to the Statistical office by UNMIK, and found it to be a completely different place. Not only were the physical offices left barren, but any work that had been done under the priorities of the Yugoslavian government was gone. "There was no data to work with - nothing," says Rexhepi. He worked hard for results. In three years he spearheaded a project to harmonize the statistical system of Kosovo, and when the opportunity with BPK arose, Rexhepi had much to be proud of.

"My thoughts when I applied for the job were that I would be able to continue the work of BPK, and develop my management skills," he remembers. With his experience in insurance Rexhepi was well aware of the challenges facing the insurance industry. Although many companies existed, they were operating without any guidelines or laws. Rexhepi had read alot about BPK and understood the significance of what it had undertaken. He was eager to take part in the regulatory process. "A developed insurance and financial sector is important for a successful economy," he acknowledges. "Rules and regulations are very helpful for companies to develop their operations and products."

USAID provided Advisors from Bearing Point, a US based consulting organization, to assist BPK. With their guidance and training, Rexhepi, along with others in the office, benefited greatly. "The contribution the advisors have made has been extremely productive," Rexhepi remarks with admiration. "They are excited to come in and build something new - working with them gives me the same excitement."

But the international advisors will not be around forever. BPK is in the process of "Kosovarization" - or putting all of its operations under local management. Rexhepi values the knowledge that he can gain from the internationals he works with. He recognizes that training is the only way to sustain the operations of BPK. "Education is very important," he says as he picks up a hefty pile of papers from the center of his desk. "These are my staff's suggestions for future trainings."

Recently returning from a seminar in Sofia, Rexhepi is proud of what Kosovo has accomplished. "The insurance and finance institutions here are some of the best organized in the region." The transformation is remarkable. "People need to be willing to make changes," he says, "or else they will be left out of the process". ☘



**May 2001 - July 2003**  
The American Bank of Kosovo

**Total loans:** 2,408 SME loans totaling 64.5 million euro  
 53% of these loans are in the labor-intensive manufacturing and production sectors, and 10% of loans are to the agricultural sector

**Number of jobs created as result of SME loans:** 5,348

**% of SME loans fully current on their payments:** 96%

**Number of bank branches:** 16 branch bank locations providing a full range of financial services to SMEs and the citizens of Kosovo

**International transfer fees:** 0.3%

**Total deposits:** 70 million euros being mobilized and reinvested into Kosovo through SME lending activity.

**Number of local citizens employed:** Approximately 270 local citizens hired and trained to operate and manage the bank.

**Banking and Finance in Kosovo as of August 2003**  
**FACTS**

**# Licensed Banks:** 7 full service commercial banks

**# Licensed Branches/sub-branches:** 146

**Total assets in the banking system:** 666 million euros

**Total deposits:** 490 million euros - 17% increase since the start of the year, and the highest level since December 2001, the start of the euro conversion

**Total Loans:** 177 million euros - 106% increase since the start of the year

**USAID/KOSOVO STRATEGIC PLAN 2004 - 2008**

In September 2003 the USAID Mission in Kosovo released its Strategic Plan 2004 -2008. Programs developed under the new Strategy will further develop several areas of assistance as well as undertake new some initiatives.

The USAID Strategic Plan can be viewed online at <http://www.usaid.gov/missions/kosovo/>

The following is a summary of the plan's Strategic objectives and their Results:

**ECONOMIC DEVELOPMENT**

- **Improve the policy and institutional climate for productive investment ●**  
 Results:  
 Institutionalized budget and tax systems  
 Improved financial and regulatory systems  
 Improved public policy and legal environment  
 Increased integration into regional trade  
 Privatized government assets
- **Accelerate the growth of the private sector ●**  
 Results:  
 Increased competitiveness of the agricultural sector  
 Improved capacity of private enterprises  
 Improved business operating environments

**DEMOCRACY AND GOVERNANCE**

- **Make civil society and government more effective partners to achieve good governance ●**  
 Results:  
 Better informed citizens  
 Increased citizen influence on public policy decisions  
 A more accountable and transparent local government  
 Key functions of municipalities are fulfilled more efficiently
- **Create an open and responsive government acting according to the rule of law ●**  
 Results:  
 Representative elections administered by Kosovars  
 Legal frameworks that ensures checks and balances  
 Fair and transparent administration of justice

**SPECIAL OBJECTIVES**

- **Anti-Trafficking ●**  
 Results:  
 A functioning support system for victims of trafficking
- **Energy ●**  
 Results:  
 Increased efficiency of the electricity sector