Financial Institutions and Services

The Impact of Foreign Banks Presence on the Performance of Domestic Banks in Kosovo during the Period 2001-2007

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Abstract: The purpose of this study is to empirically research the impacts of the foreign bank's presence on the performance of domestic banking sector in Kosovo. The research data on foreign and domestic banking are quarterly time seri data gathered by the Central Bank for the period 2001-2007. By using the compatible data on seven commercial banks, we introduce how the net interest margin, non interest margin, overhead cost, tax paid, and profitability differ between the foreign and domestic banks. We find that the foreign banks have higher net interest margin and profit than the domestic banks. The research outcome indicates that the presence of foreign banks had a negative and statistically significant impact on the net interest margin and loan loss provision of domestic banks, but positively related to the non-interest income, overhead cost and profitability of domestic banks, but we did not find any statistically significant values. The general conclusion is that the presence of foreign banks has not influenced on the increase of competitiveness.

Keywords: foreign banks; domestic banks; performance

JEL Classification: G21; G24

1. Introduction

As the foreign banks entered in the transition countries from year 1990, following the liberalization of financial markets, such process took place in Kosovo after the same year, as a consequence of ethnical conflicts in former Yugoslavia. In most of the transition countries, the liberalization process was the main topic of discussions between policymakers and academics concerning the benefits and costs of the entry of foreign banks in the economies of respective countries. Unfortunately, such a discussion was never made in Kosovo due to the inexistence of the Banking Sector and other financial institution therein. As of year 2000, the Kosovo financial sector has therefore been open and liberalized enabling thus a free-from-obstacles entry of foreign banks in the Kosovo's banking market. However, what most of the authors agree upon is that financial markets were liberalized and obstacles were removed for the purpose of benefiting from the entry of foreign financial institutions, which aim to foster competitiveness and increase efficiency.

This paper aims to contribute to the literature by providing empirical evidence on the impacts that the foreign banks presence has on the performance of Kosovo banking sector. In doing this, we use the OLS regression model in order to test a number of research hypotheses.

In addition, this paper differs from other studies made in transition countries in many aspects:

Firstly, the banking sector of Kosovo was re-established upon foreign banks entry at the time when no domestic-owned bank operated in the Kosovo banking sector. Thus, the share of foreign banks in the total of assets was 100% in 2000. Later on, five domestic-owned banks and one foreign-owned bank were established in 2001.

Secondly, given that the Kosovo banking sector, which can be considered as liberalized in terms of regulatory perspective, has no control on the interest rates, it has no program on direct loan and no control on capital account either.

Getting to assess the impacts of the foreign banks presence in the banking market, it is necessary to research the differences between the performance of domestic banks and foreign banks. Although the number of foreign banks entered was increased since year 2000, few studies have been made to assess the comparative performance of foreign and domestic banks. Besides, no econometric analyses have been made to study the impacts of the foreign banks entry.

The paper is organized as follows: firstly an overview of the banking sector development and foreign banks entry process is given, and then a description of literature, research hypotheses, data and methodology, estimation results, and conclusions are presented.

2. Overview of Kosovo banking sector

2.1. Development of Kosovo Banking Sector and entry of foreign banks

The reconstruction of economic and financial system was embedded in the building of new relevant institutions started after the conflict of 1999. The establishment of a new banking system based on market principles was a very important element of the reconstruction. The Kosovo financial and banking system did not exist before the conflict of 1999, thus Kosovo established the financial system from the very beginning. Following year 1999, Kosovo was administered by the United Nations Organizations. International and local authorities were committed to establish a banking sector in compliance with international standards as well as to create a more adequate environment for attracting foreign capital in the banking sector. The establishment of the Banking and Payments Authority of Kosovo in 1999, which was then transformed into the Central Bank of the Republic of Kosovo in 2008, was a direct outcome of these efforts. The basis of two tier banking system was established.

The Central Bank of Kosovo is the highest authority within the financial sector, which operates as a Regulatory and Oversight Authority for the commercial banks and other financial institutions. In the framework of the financial system, the commercial banks are the most important financial intermediaries in Kosovo by 90.9 % of the total of assets in the financial system at end of 2007 and by 90.8 % in 2008. They are almost the only source of financing because the non-banking financial institutions are not developed and their role as intermediary institutions in channelling the financial savings on investments is insignificant. This indicates that the Kosovo's economy, particularly the small and medium enterprises (SME), is highly depending on the commercial banks. The money and capital market, as segments of financial market, does not exist. The lack of the financial market and the not long developed banking system make the financing of many SME investment projects very difficult.

As in many transition countries, the banking sector is dominated by institutions owing foreign capital. The structure of Kosovo banking sector has changed over these years. No bank operated in Kosovo during 1999. Therefore all commercial banking operations were carried out by the Banking and Payment Authority of Kosovo.

In January 2000 the first bank called Micro Enterprise Bank (MEB) was established, which in November 2003 was transformed into ProCredit Bank. In November 2001 the American Bank of Kosovo (ABK), another foreign-owned bank, was established, which in July 2003 was bought by the Raiffeisen Bank of Kosovo (RBKO).

Over year 2001, other five domestic-owned banks were established. Thus, the number of commercial banks amounted to seven.

This banking sector structure remained unchanged as of the end of year 2007. By the beginning of year 2008 a Slovenian Bank, called Nova Ljubljanska Banka (NLB), bought 50.1% of the Kasabank's (KSB) shares, which together with the 25.1% of shares owned by another Slovenian Bank, Factor Bank Ljubljana, increased the foreign capital share of KSB to 75.2%.

Moreover, NLB became a shareholder of Banka e Re e Kosovës (BRK), by buying 87.0% of its shares. This process continued afterwards with the merging of KSB and BRK in one single bank, the NLB Prishtina, in January 2008.

In addition, two other banks, the Banka Kombëtare Tregtare (BKT) from Albania and Komercijalna Banka (BK) from Serbia were licensed. Another foreign bank, the Turk Ekonomi Bankasi (TEB), was licensed by the Central Bank of Kosovo, according to the Central Bank of Kosovo Report 2007.

In 2008, the banking market was dominated by the foreign banks in terms of both number of banks and the share in the total of banking sector means. Hence, we may count seven foreign-owned banks and two domestic-owned banks. The foreign banks assets share in the total of banking sector's assets was 91.0%, whilst their share in the total of banking sector's means was 90.9% in 2007.

3. Literature Overview

Many studies have been made to research the impacts of foreign banks presence in the domestic banking sector. These studies may be classified in two groups: the one that elaborates the impacts across countries and the one focused on the impacts of foreign banks entry in particular countries. Studies, made in both many countries and a particular one, indicate that the foreign banks presence in the domestic banking sector has influenced on the increase of competitiveness in the banking sector, which simultaneously stimulates the domestic banks to enhance their efficiency, thus influencing on the performance of domestic banking sector.

Claessens, Demirgüç-Kunt, and Huizinga (2001) have, by using the banks level data for 80 developed and developing countries over the period 1988-1995, researched the impact that the foreign banks entry has on the net interest margin, profitability, non-interest incomes, overhead expenses, and on loan loss provision. They ascertained that the increase of foreign banks presence has been followed by a decrease in the profitability, non-interest incomes, and overhead expenses of domestic banks. In addition, the results have not shown a significant impact on the net interest margin and loan loss provision. These results indicate that the foreign banks entry has positive impact on the banking sector efficiency.

Hermes and Lensink (2001) have further developed the analysis of Claessens at al (2001) by using the banks level accounting data from 990 commercial banks in 48 countries for the period 1990 – 1996. They researched the impact of foreign banks entry in the domestic banking market of less developed countries (LDCs) and found results that contradict the ones of Claessens et al (2001). According to them, the presence of foreign banks drives to the increase of revenues, profit, and costs. They also indicated that the foreign banks entry may have a different impact on the domestic bank market of developed and less developed countries.

Hermes and Lensink (2004) explained the relation between the performance of foreign banks presence and domestic banks by taking into account the level of financial system's development. They used the data from 982 banks in 48 countries between year 1990 and 1996. They proved that when the financial development level is low, the foreign banks presence induces the increase in cost and profit margin of domestic banks, whilst when the financial development level is high; it induces a fall in costs and profit margin of domestic banks.

In addition, Hermes and Lensink researched in (2004) the short-term impacts of foreign banks presence in the domestic banking operations by taking into account the economic development level. This study was conducted by using the data of Beck, Demirguc-Kunt and Levine (2000) and Bank Scope. This paper includes 3.967 samplings between years 1990 and 1996. They show that, in short term, the foreign banks presence is associated with the increase of expenses and interest rate spread of domestic banks at lower level of economic development. Meanwhile, at higher levels of economic development, the results obtained appear to be somehow contradictory because the finding from studies conducted show that the foreign banks presence is either associated with a fall of cost, profit, and interest spread rate or has no impact on these bank variables.

There are conducted more studies which are focused within one country. Denizer (2000) analysed the impact of foreign banks presence on domestic banks in Turkey. He empirically arguments that as the foreign banks entered the banking market of Turkey, the net interest margin, return of assets, and overhead expenses of domestic banks fell. These results support the idea that the foreign banks put pressure on domestic banks in Turkey in terms of competitiveness.

Unite and Sullivan (2001) analysed the impacts of foreign banks entry in the domestic banking sector of Philippine during the 1990-1998 period. They show that the foreign banks presence is associated with the reduction in difference of interest rate and profit of banks, but only for those domestic banks that are affiliated to a family business group.

Zajc (2002) analysed the impacts of foreign banks entry in the domestic banking sector of transition countries (Chezk Republic, Estonia, Hungary, Poland, Slovakia, and Slovenia) during the 2001 – 2007 period. He has find that the foreign banks entry reduces the non-interest revenues and profit, and simultaneously increases the cost of Central and Eastern European domestic banks.

Janek Uiboupin 2004 analysed the short-term impacts of foreign banks entry on the performance of domestic banks of Central and Eastern European countries. He used the data from 219 banks of ten countries. He showed that the foreign banks entry has a negative impact on domestic banks incomes from interest-earning assets, non-interest incomes, and profitability. The foreign banks entry may also increase the overhead cost of domestic banks at a shorter term.

4. Hypotheses

The hypotheses of this study are based on the theoretical and empirical literature. The studies show that the foreign banks presence influences on the net interest margin, non-interest incomes, overhead cost, profitability and loan loss provision of domestic banks by having an impact on the competitiveness and efficiency of domestic banks. The increase in competitiveness caused by the foreign banks presence in the domestic banking sector makes the domestic banks pay higher deposits interests in order to avoid their market share and at the same time, makes them to apply lower interest rates on loans. Given that the interest income is decreased and interest expenses increased, the foreign banks presence is associated with the falling of net interest margin. The net interest margin is the difference between the interest income generated by loans and interest expenses in deposits.

This reduction in the distinction between interest differences is an important indicator of competitiveness, because the banking sector becomes more competitive when the loan interest rates are expected to be reduced, whereas the deposits interest rate is expected to increase. Denizer (2000), Unite and Sullivan (2001), and Uiboupin (2004) have found an inverse relation between the foreign banks presence and net interest margin, while Claessens, et al. (2001) has not found any significant relation.

In addition, we assume the increase of competitiveness in Kosovo's banking market upon the increase of foreign banks presence.

H1. The increase of foreign banks presence has an impact on the reduction of net interest margin of domestic banks.

The reduction of net interest margin of domestic banks due to the increase of competition as a result of higher foreign banks presence makes the domestic banks to search for other sources of interests incomes from non-loans operations. We assume that the domestic banks will try to increase the non-interest income in order to compensate the fall of interest margin. However, if the foreign banks provide services with better prices than the domestic banks, it is expected that the non-interest income will be reduced as a result of the increase of competitiveness by foreign banks. Although the generation of profit from non-loan operations happens in short terms, it has a long term results.

H2. The increase of foreign banks presence has a positive or negative impact on non-interest income of domestic banks.

The foreign banks presence may have a positive or negative impact on the overhead cost of domestic banks. The foreign banks may have a lower cost than domestic banks; therefore the domestic banks should strive to reduce the cost in order to be competitive with foreign banks. The studies conducted by Claessens, et al. (1889), Unite and Sullivan (2001), Bayraktar and Wang (2005) have shown a negative relation between the foreign banks presence and overhead cost. This is however a short term impact. In addition, it could be that the presence of foreign banks and the cost of domestic banks be connected in a positive fashion. The domestic banks are obliged to make new investments in order to be able to compete with foreign banks which own a more advance banking technology and more qualified staff. Therefore, this causes the increase of cost in a short-term period. The studies conducted by Hermes and Lensink (2001, 2004a, 2004b); Uiboupin (2004); Micco, et al, (2004) show a positive relation between the foreign banks presence and overhead cost.

H3. The increase of foreign banks presence impacts the overhead expenditure of domestic banks

The foreign banks entry is usually expected to have a positive impact on the banking market competitiveness, and for this reason, it is also expected to have a negative impact on the domestic banks profitability. A number of studies conducted by Denizer, (2000), Claessens, et al,(2001), Unite and Sullivan, (2001) and Uiboupin, (2004), show a negative relation between the foreign banks presence and domestic banks profitability. Therefore, the following hypothesis has been also elaborated herein in order to evidence the impact of foreign banks presence on the domestic banks profitability in Kosovo.

H4. The increase of foreign banks presence has a negative impact on the domestic banks profitability.

The effect of foreign banks entry on the loan loss provision of domestic banks might have a positive or negative impact on the quality of loans. The increase of loan loss provisions may be based on the affirmation that the domestic banks are obliged to attract clients having lesser loan capacities due to the increase of competitiveness resulting from the foreign banks entry. Claessens, Demirgüç-Kunt, and Huizinga (2001), Uiboupin (2004), Bayraktar and Wang (2005 have proved that the increase of foreign banks presence may encourage the domestic banks to have clients with relatively lower loan-return capacities, thus increasing the banks risk.

On the other hand, the foreign banks presence may have an impact on the reduction of loan loss provisions of domestic banks, given that domestic banks pay particular attention to the loans that they give in order to avoid the loss due to increase of competitiveness.

H5. The foreign banks presence has a positive or negative impact on loan loss of domestic banks

5. Data

We will use the quarterly data including the period 2001: Q1-2007: Q4 in the empirical analysis of foreign banks presence in the banking sector of Kosovo. The data used in this paper are drawn from the Central Banks of Kosovo and contain records from the balance sheet and income statements of seven commercial banks, out of which, two are foreign-owned banks. This study does not include a domestic bank due to lack of quarterly data and to its bankruptcy at the beginning of year 2006. Banks are defined as foreign if at least 50% of their shares are foreign-owned. According to Cleassens, there are two ways to measure the foreign banks entry ratio. The first way is to compute the assets share of foreign banks as share of total of the banking sector assets. This measuring is more adequate if the foreign banks have an impact on the price and profitability of domestic banks only when they get to the considerable size.

The second way of measuring is the number of foreign banks as share of total number of banks in the banking sector. Classens et al (2001) says that this measuring is adequate if the number of foreign and domestic banks determines the competition criteria.

Table 1 shows the share of foreign banks average assets in the total of banking sector assets, which is almost 70 percent. The foreign banks share in assets was quite higher than their share in the total number of banks. Therefore, we may conclude that the foreign have a higher share in the Kosovo banking market.

Table 1. Structure of assets by ownership, (in percent)

Ownership	***2000***	***2001***	***2002***	***2003***	***2004***	***2005***	***2006***	***2007***	***2008***
Domestic Banks	-	*27%*	*26%*	*36%*	*37%*	*33%*	*28%*	*9.1 %*	*10%*
Foreign Banks	*100%*	*74%*	*74%*	*64%*	*63%*	*67%*	*72%*	*90 %*	*90%*

Source: author's calculation

Table 2 shows the foreign banks share in the total number of banks. The number of foreign banks has remained the same until 2007.

Table 2. The Kosovo Banks' ownership structure (number of banks)

Ownership	*2000*	*2001*	*2002*	*2003*	*2004*	*2005*	*2006*	*2007*	*2008*
Domestic Banks	-	*5*	*5*	*5*	*5*	*5*	*4*	*2*	*2*
Foreign Banks	*2*	*2*	*2*	*2*	*2*	*2*	*2*	*7*	*7*

Source: Central Bank of Kosovo http://www.bqk-kos.org

We have used the in this paper the accounting data in order to elaborate how foreign banks differ from domestic banks in terms of net interest margin, non-interest income, profitability, paid tax, overhead cost, and loan loss provision. Like the renowned economists Dermirguc - Kunt and Huizinga (1999), we use simple accounting identity which includes:

NIM + NII/TA + PBT /TA + OE /TA + LLP/TA

NIM = Net interest margin

NII = Non-interest income

PBT = Profit before tax

OE = Overhead expenses

LLP = Loan loss provisions

We use two variables to measure the banks incomes: The net interest margin (NIM) and non-interest income over the total of assets. The net interest margin presents the interest income generated by loans operations, while the non-interest income presents all other sources of incomes generated by non-loans activities such as fees and commissions.

Secondly, the profitability of banks is characterized by the profit before tax over the total of assets. Whereas, the overhead cost representing the banks operations costs are measured with two variables; the overhead expenses and the loan loss provisions over the total of assets.

Based on the data presented in the Table 3, we may notice the average value of performance indicators of foreign banks and domestic banks for the 2001 – 2007 periods.

Table 3. Performance indicators of Domestic vs Foreign banks 2001 2007

(Average, in percent)

Ownership	Net margin / ta	Non-Int. income / ta	Overhead / ta	Tax / ta	Loan. Loss prov/ta	Net profit / ta
Domestic Banks	4.77%	3.41%	4.92%	0.23%	2.14%	0.95%
Foreign Banks	5.44%	2.0%	4.39%	0.51%	0.72%	1.89%

Source: author's calculation

In general, the foreign banks generate a higher net interest margin and profitability than domestic banks, whilst the domestic banks had higher non-interest income, overhead expenses, and loan loss provisions than the domestic banks.

According to Classens et al 2001, the high net interest margin of foreign banks in comparison to the domestic banks of developing countries reflects the market conditions of the hosting country wherein the foreign banks operate. For example, in the developing countries, the foreign banks may have higher net interest margin than the domestic banks because they may be released form restriction rules, and they do not operate on non-commercial criteria as many state-owned banks operate and apply modern banking practices which mostly evaluate the disadvantages of their information.

6. Empirical Model

The aim of this study is to measure the impact of foreign banks presence on domestic banks. To that respect the empirical model used here has been mainly derived from Claessens et al. (2000) but adapted to this study in order to reflect the objectives which are twofold:

1. Estimate the impact of foreign bank presence (i.e. passive presence) on domestic banks; this is achieved by using as a dependent variable the ratio measuring the foreign banks' share over the total shares of the banking sector.
2. Estimate the impact of foreign bank performance (i.e. active presence) on domestic banks performance; this is done by using as dependent variables performance ratios which are described below.

One of our main targets is to determine the relationship between domestic banks' performance indicators and foreign bank entry, first independent variable introduced is the asset share of foreign banks.

As such the model used is as follows:

$y_i^d = \alpha + \beta x_i^f + \varepsilon_i$ g

Where y_i^d is the dependent variable representing the performance of domestic (d) bank (i) and x_i^f is the independent variable representing the performance of foreign (f) bank (i). The variables used here for measuring banks' performance are the following:

- First dependent variable is net interest margin to total assets;
- The second dependent variable is the ratio of non-interest income to total assets;
- Third dependent variable is ratio of before tax profit in total assets;
- Fourth dependent variable is ratio of overhead costs to total assets;
- The last dependent variable is the ratio of loan loss reserves to total assets.

The parameters will be estimated using OLS regression technique in SAS by way of R^2 maximization

7. Result of the Empirical Analysis

The results generated by the foreign banks presence and domestic banks performance for the 2001-2007 periods are shown in Tables 4 to 8. We have presented the result on each of five variables of domestic banks' performance, including the net interest margin, non – interest income, profitability, overhead cost, and net loan loss provision over the foreign banks' share as an independent variable.

The result presented in Table 4 shows that the foreign banks presence has a negative and statistically significant impact on the net interest margin of domestic banks. Since the foreign banks presence is negatively related to the net interest margin, we may conclude that the foreign banks presence had an impact on the reduction of net interest margin of domestic banks.

The SAS System

The REG Procedure

Dependent variable: Net interest Margine / total assets of Domestic banks

R-Square = 0.7625

Table 4 (Number of observation is 30)

Variable	Parameter Estimate	Standard Error	Type II SS	F Value	Pr > F
Intercept	0.15594	0.04640	0.00055295	11.30	0.0028
Foreign_share / total assete	**-0.09354**	**0.03045**	**0.00046193**	**9.44**	**0.0056****
Equity / ta_Boreign banks	0.00344	0.23298	1.066081E-8	0.00	0.9884
NII / ta_Foreign banks	0.86382	0.23118	0.00068346	13.96	0.0011
CustFunding / ta_Foreign banks	-0.10003	0.04347	0.00025917	5.29	0.0312
Overhead_Expenditures / ta_Foreign banks	0.81130	0.78844	0.00005183	1.06	0.3147

Source: author's calculation

Note:

*Significant at 10 per cent level;

**Significant at 5 per cent level;

***Significant at 1 per cent level.

The SAS System

The REG Procedure

Dependent variable: Non interest income / total assets of Domestic banks

R-Square = 0.7080

The results of testing the second hypothesis concerning the impact of foreign banks presence on non-interest income of domestic banks are presented in Table 5. We find that the foreign banks presence is positively related to the non-interest income of domestic banks, but we did not find any statistically significant values.A potential reason for this positive sign could be the case when domestic banks, due to the fall of interest income, started to focus their activities in generating noninterest income by establishing branches and sub-branches throughout the country.

Table 5. (Number of observation is 30)

Variable	Parameter Estimate	Standard Error	Type II SS	F Value	Pr > F
Intercept	0.02275	0.04479	0.00001176	0.26	0.6166
Foreign_share / total asete	**0.00277**	**0.02939**	**4.063243E-7**	**0.01**	**0.9257**
Equity / ta_Foreign banks	0.51015	0.22489	0.00023472	5.15	0.0335
NII / ta _Foreign banks	1.32291	0.22316	0.00160	35.14	<.0001
CustFunding / ta_Foreign banks	-0.04518	0.04196	0.00005288	1.16	0.2933
Overhead_Expenditures / ta_Foreign banks	-0.37064	0.76106	0.00001082	0.24	0.6311

Source: author's calculation

Note:

*Significant at 10 per cent level;

**Significant at 5 per cent level;

*** Significant at 1 per cent level

The SAS System

The REG Procedure

Dependent variable: Profit before tax / total assets of Domestic banks

R-Square = 0.7669

The results of testing the third hypothesis concerning the impact of foreign banks presence on profitability of domestic banks are presented in Table 6. We find that the foreign banks presence is positively related to the increase of profitability of domestic banks, but we did not find any statistically significant values. Our interpretation on this result is that the foreign bank presence is not associated with a higher competition in domestic banking system. Classens 2001 finds that by keeping other factors unchanged, the high profits reflect a lack of competitiveness, whilst the higher cost of expenditures may reflect less management efficiency and a poor organizational structure.

Table 6 (Number of observation is 30)

Variable	Parameter Estimate	Standard Error	Type II SS	F Value	Pr > F
Intercept	0.01950	0.02466	0.00000865	0.63	0.4374
Foreign_share_total assete	**0.01640**	**0.01618**	**0.00001420**	**1.03**	**0.3218**
Equity_ta_Foreign banks	0.61592	0.12382	0.00034214	24.74	<.0001
NII_ta_Foreign banks	0.52142	0.12287	0.00024902	18.01	0.0003
CustFunding_ta_Foreign banks	-0.05245	0.02310	0.00007126	5.15	0.0333
Overhead_Expenditures_ta_Foreign banks	-1.18029	0.41903	0.00010970	7.93	0.0100

Source: author's calculation

Note: *Significant at 10 per cent level;

**Significant at 5 per cent level;

*** Significant at 1 per cent level

The SAS System

The REG Procedure

Dependent variable: Overhead cost / total assets of Domestic banks

R-Square = 0.1946

The results of testing the fourth hypothesis concerning the impact of foreign banks presence on overhead expenses are presented in Table 7. We find that the foreign banks presence is positively related to the overhead expenses, but we did not find any statistically significant values. This increase of overhead costs of domestic banks results from the expenses incurred in operations, such as purchase of new equipments, training of employees, etc. Hermes and Lesnik 2002 find that the increase of foreign banks presence increases the cost of domestic banks. Zajc 2002 finds that the foreign banks entry increases the cost of domestic banks in Central and Eastern Europe countries.

Table 7 (Number of observation is 30)

Variable	Parameter Estimate	Standard Error	Type II SS	F Value	Pr > F
Intercept	0.01002	0.02623	0.00000228	0.15	0.7062
Foreign_share_total assets	**0.00532**	**0.01722**	**0.00000149**	**0.10**	**0.7603**
Equity / ta_Foreign banks	0.12834	0.13173	0.00001485	0.95	0.3405
Non-interest income / ta _Foreign banks	0.26836	0.13071	0.00006596	4.22	0.0521
Customer Funding / ta_Foreign banks	-0.00879	0.02458	0.00000200	0.13	0.7239
Overhead_Expenditures / ta_Foreign banks	-0.26712	0.44579	0.00000562	0.36	0.5551

Source: author's calculation

Note:
*Significant at 10 per cent level;
**Significant at 5 per cent level;
***Significant at 1 per cent level

The SAS System

The REG Procedure

Dependent variable: Loan loss provision/ total assets of Domestic banks

R-Square = 0.5831

The results of testing the hypothesis concerning the impact of foreign banks presence on loan loss provisions are presented in Table 8. We find that the foreign banks presence has a negative impact on the loan loss provisions of domestic banks. A potential reason for this negative sign could be the case when the foreign banks presence influenced on the domestic banks to be more prudent in issuing loans. Claessnes et al 2001 finds that as foreign bank share increases, the loan loss provisions fall.

Table 8 (Number of observation is 30)

Variable	Parameter Estimate	Standard Error	Type II SS	F Value	Pr > F
Intercept	0.08524	0.04336	0.00016520	3.86	0.0621
Foreign_share_total assets	**-0.10679**	**0.02846**	**0.00060204**	**14.08**	**0.0011*****
Equity / ta_Foreign banks	-0.55194	0.21771	0.00027475	6.43	0.0189
Non-interest income / ta _Foreign banks	-0.27979	0.21604	0.00007170	1.68	0.2087
Customer Funding / ta_Foreign banks	0.01591	0.04062	0.00000656	0.15	0.6990
Overhead_Expenditures / ta_Foreign banks	2.17778	0.73678	0.00037348	8.74	0.0073

Source: author's calculation

Note:

*Significant at 10 per cent level;

**Significant at 5 per cent level;

***Significant at 1 per cent level.

8. Conclusion

In this paper, we have empirically analysed the impact of foreign banks entry on the domestic banks of Kosovo, by using the quarterly time seri data on seven commercial banks for the period 2001 -2007. The Kosovo banking system has considerably changed over these years of its operation. The foreign banks have played a very important role on the development of modern banking sector in Kosovo, because they assisted the reestablishment of banking sector by contributing in the improvement of quality and quantity of Financial Services.

The empirical results show that the foreign banks presence had a negative impact on the interest rate spreads and provision of domestic banks. Whereas, the foreign banks presence in Kosovo did not have a significant impact on the profitability and non-interest income of domestic banks in Kosovo.

The overall conclusion from this empirical analysis is that the foreign banks presence in Kosovo has not increased the competitiveness in the banking sector

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