

UDC 336.712:332.146.2

DOI: 10.31891/2307-5740-2021-298-5(2)-17

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## REGIONAL BANKS AS A NECESSARY TOOL TO STIMULATE SOCIAL AND ECONOMIC DEVELOPMENT OF THE REGIONS OF UKRAINE

*The role and importance of regional banks in stimulating the socio-economic development of the regions of Ukraine were investigated. The author's vision of such definitions as regional banks and the regional banking system is offered. It is established that the regional banking system of Ukraine has undergone a significant reduction in recent years and has a very small share of assets, liabilities, and capital in the total banking system of the country. It is proved that the National Bank of Ukraine does not take into account the importance of having a regional banking system and ensuring the balanced socio-economic development of the regions of Ukraine. Examples of the organization of banking business of the USA and Germany are given. It is substantiated that regional banks can be full-fledged subjects of the modern banking system only with some support from the NBU and local authorities.*

*Keywords: regional banks, National Bank of Ukraine, regional banking system, socio-economic development, state support of the regional banking system.*

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## РЕГІОНАЛЬНІ БАНКИ ЯК НЕОБХІДНИЙ ІНСТРУМЕНТ СТИМУЛЮВАННЯ СОЦІАЛЬНО-ЕКОНОМІЧНОГО РОЗВИТКУ РЕГІОНІВ УКРАЇНИ

*У статті здійснено аналіз діяльності регіональних банків в Україні та обґрунтовано їх вплив на стимулювання соціально-економічного розвитку регіонів України. Запропоновано авторське бачення таких дефініцій, як регіональні банки, та регіональна банківська система, де остання визначається як частина банківської системи регіону і об'єднує виключно вітчизняні комерційні банки, що мають не менше половини своїх структурних підрозділів у даному регіоні. Встановлено, що регіональна банківська система України останніми роками зазнала суттєвого скорочення та має досить невеликі значення питомої ваги активів, зобов'язань та капіталу у загальних обсягах банківської системи країни. Визначено, що діяльність регіональних банків свідчить, що з кожним роком їм стає все складніше витримувати ціновий тиск з боку системних вітчизняних та іноземних банків. Доведено, що Національний банк України не враховує важливість наявності регіональної банківської системи та забезпечення рівномірного соціально-економічного розвитку регіонів України, а орієнтується на виконання згубних для невеликих регіональних банків, багатьох середніх та малих підприємств реального сектору економіки, для вітчизняної економіки в цілому рекомендацій наднаціональних фінансових регуляторів. Наведено приклади організації банківської справи США і Німеччини, яка ґрунтується на регіональному принципі організації банківської справи. Показано, що вітчизняна практика та зарубіжний досвід свідчать, що банківські кредити можуть більш ефективно сприяти розвитку інноваційної економіки в регіонах, якщо вони будуть видаватися підприємствам, з якими банки знаходяться в тісному і тривалому взаємовигідному співробітництві. Обґрунтовано, що регіональні банки можуть бути повноправними суб'єктами сучасної банківської системи лише при наявності певної підтримки з боку НБУ та місцевих органів влади.*

*Ключові слова: регіональні банки, Національний банк України, регіональна банківська система, соціально-економічний розвиток, державна підтримка регіональної банківської системи.*

### Introduction

The modern regional economy of Ukraine is characterized by a significant lag in lending volumes from the potential borrowing needs of economic entities. It especially concerns the activities related to the introduction of innovations for industrial and agricultural enterprises, modernization, and expansion of their production. Bank credit

does not properly fulfill its function as a strategic factor of development, which leads to a reduction in business activity in many priority sectors of the economy. Concurrently, in the modern world the development and well-being of certain territories subject to the existence of a developed diversified banking system capable of performing all the functions of money and credit to the full extend.

#### **Analysis of research and publications**

The development of the banking system at the regional level has received so much attention from foreign and domestic scholars, such as M. Bale, A. Berger, T. Zverkova, D. Kleshko, Musayev, M. Neil, R. Faltermeier, H. Hakenes, M. Hirst, as well as O. Baranovsky, O. Vasylyk, T. Havrilko, O. Hasia, Z. Herasymchuk, O. Dzyublyuk, D. Zavadska, M. Mohilnytska, O. Moroz, T. Smovzhenko, G. Tabachuk, and others.

**The main purpose of the article** is to study the role and importance of regional banks in stimulating the socio-economic development of the regions of Ukraine.

#### **Presentation of the main research material**

The leading factor in the successful operation of regional banks is the creation of conditions for the formation of a local value chain of products with high value-added. It serves the needs of the regional economy as a regional financial intermediary. The territorial proximity of the regional bank to the representatives of small and medium businesses facilitates access to the so-called local information during the implementation of lending. At the same time, its consistency in providing a range of banking services, preserving stable areas of activity, maintaining its high business reputation and strong positions in the regional market of banking services is of great importance. It is also important that the high adequacy of capital base and the level of free liquidity characterize many banks, in particular, corporate regional banks.

The processes of monopolization of the banking sector are an objective reality for the modern economy of Ukraine. The permanent nature of the economic crisis only accelerates this movement. Ultimately, few banking institutions have full power in the banking market and the economy as a whole. Such a situation cannot be considered unambiguous.

On the one hand, large bank capital shows the growth of profits, increases the level of stability of the entire banking system, and creates conditions for more effective supervision of banks by the National Bank of Ukraine (NBU) as a whole. On the other hand, monopoly banks gain unlimited power in the market, tending to overestimate a credit rate and underestimate a deposit rate, and to ration credit proposals for domestic producers, which reduces its innovation activity and inhibits technological modernization. Besides, banking monopolization poses a systemic risk, when the bankruptcy of a large bank causes a continuous financial crisis, which can cause crises for the entire economy. And then the negative consequences of the formation of banking monopolies more than outweigh the possible benefits and contributes to the unproductive spending of public funds and the growth of external debt to save troubled banks. At the same time, there is a significant reduction in the share of socially significant items of budget expenditures, which affects the quality of social security, leads to deepening social inequality, and slows down the economic development of the country.

Approximately, over the last six years, the total number of banks in Ukraine has been declining. Thus, as of July 1, 2014, the number of banks with banking license was 174 (of which 19 banks with 100% foreign capital – this was 11% of the total number of banks), and as of January 1, 2020 – 75 (23 of them are banks with 100% foreign capital – this is 31% of the total number of banks) [1]. At the same time, there is a territorial concentration of the number of banks, as well as their assets. As of January 1, 2021, the city of registration of the dominant part of the country's banking institutions is the city of Kyiv, which is 74% of the total number of banks (see table).

The process of liquidation of banks for the period under study is also characterized by significant territorial disparities. Thus, for the period from 2014 to 2020, the relative number of banking institutions increased in Kyiv (by 6.2%) and in the Western region (by 2.8%). At the same time, there was a significant reduction in the share of banks in the Eastern region (by 7.1%). If in 2014, the Donetsk region was the place of registration of seven, and the Luhansk region – two banks, today there is none. As of July 1, 2014, only two of the five Kharkiv-registered banks remain.

The study of changes in the share of banks in the territorial registration of banking institutions shows that the process of liquidation of banking institutions affected regional banks largely, which had a very ambiguous effect on the possibility of fuller use of all components of economic potential and regional development. It is worth noting that the existence of a developed regional banking system can contribute to the uniform development of the country's territories and smooth out the disparities in their spatial development. Moreover, under these conditions, it is not the location of the bank registration, but a significant concentration of structural units of the bank within one region is important [2].

Accordingly, we refer to the regional banking system as a part of the banking system of the region that unites only domestic commercial banks having at least half of their structural units in the region. In contrast to the position of some scientists [3, p. 61; 4, p. 138; 5, p. 106–107; 6, p. 88–89], we believe, it is advisable to refer regional banks to the banks of a domestic owner of bank capital – private, municipal (communal), state ownership. A region is a part of the territory of Ukraine, which includes the territory of one or possibly several adjacent oblasts, which socio-economic conditions require the allocation of certain areas, priorities, goals, and objectives of social and economic development during the development of strategic planning documents.

Table 1

## Number of banks by the regions of Ukraine for 2014-2020

Region	Number of banks as of 01.07.2014 p.	Ratio, %	Number of banks as of 01.01.2020 p.	Ratio, %	Number of banks as of 01.01.2021 p.	Ratio, %
Kyiv	118	67,8	55	73,3	54	74,0
Western region	7	4,0	5	6,7	5	6,8
Lviv oblast	5	2,9	4	5,3	4	5,5
Zakarpattia oblast	1	0,6	1	1,3	1	1,4
Volyn oblast	1	0,6	-	-	-	-
Eastern region	17	9,8	2	2,7	2	2,7
Donetsk oblast	10	5,7	-	-	-	-
Kharkiv oblast	5	2,9	2	2,7	2	2,7
Luhansk oblast	2	1,1	-	-	-	-
Central region	16	9,2	6	8,0	6	8,2
Poltava oblast	3	1,7	1	1,3	1	1,4
Dnipropetrovsk oblast	13	7,5	5	6,7	5	6,8
Northern region	4	2,3	2	2,7	2	2,7
Chernihiv oblast	3	1,7	2	2,7	2	2,7
Sumy oblast	1	0,6	-	-	-	-
Southern region	12	6,9	5	6,7	4	5,5
Odesa oblast	9	5,2	3	4,0	2	2,7
Zaporizhzhya oblast	3	1,7	2	2,7	2	2,7
Total	174	100	75	100	73	100,0

A regional bank is defined as a domestic financial and credit organization that has at least half of its structural units within a particular region and which are aimed at banking services to businesses entities, individuals, and various institutions and organizations in this region [5, p. 125-126]. That is, if the number of structural units of a domestic bank operating in a particular region is not less than half (50%) of their total number, then such a bank should be considered regional.

The issue of the impossibility of referring banks with foreign shares to a group of regional banks as a prospective intermediary of social and economic development of the region needs special consideration. The problem is not only that the regional bank by definition is a part of the domestic banking sector that represents certain socio-economic interests of the territory in which it operates, which cannot be said about any foreign bank. In a crisis, a foreign bank may tend to capital outflows from the region, as well as to have non-economic (geopolitical, political, military, etc.) and speculative motives ensuring the protection of foreign corporations and further propensity to generate profits by exploiting regional resources. Moreover, historical cases of different countries show that foreign banks can contribute to the model of dependence, lag, or restraint of regions and countries when the goals of foreign banks do not coincide with the socio-economic priorities of the territories in which they operate.

Considering the state of the regional banking system of Ukraine, several operating structural units of banks in terms of regional division were analyzed. Using the official data of the NBU [7], the banks which units are concentrated in a certain area include 28 banks, of which the Kyiv oblast and the city of Kyiv have 16 banking institutions, the Kharkiv oblast - 3, the Odesa oblast - 2, and the Lviv, Zakarpattia, Poltava, Dnipropetrovsk, Chernihiv, and Zaporizhzhya oblasts - one bank each. Among these 28 banks, only 15 are domestic, which are defined as regional banks with the prospect of being involved in the implementation of regional development programs in the first place.

They include eight banks in the Kyiv oblast and the city of Kyiv - "ASVIO BANK" JSC, "BANK TRUST-CAPITAL" JSC, "IBOX BANK" JSC, "BANK ¾" JSC, Bank "ARCADA" JSC, "RwS BANK" JSC, "INTERNATIONAL INVESTMENT BANK" JSC, "CRYSTAL BANK" JSC, and one bank in each oblast - Zakarpattia, Kharkiv, Poltava, Dnipropetrovsk, Chernihiv, Odesa and Zaporizhzhia - "COMINVESTBANK" JSC, Bank "GRANT" JSC, "Poltava-bank" JSC, "CB ZEMELNY CAPITAL" JSC, "Policombank" JSC, "Bank Pivdenny" PJSC, "MetaBank" JSC, respectively.

The obtained results indicate a significant disproportion in the number of territorial locations of regional banks in Ukraine - in the capital region; their number exceeds the total number of regional banks from all other regions of the country. Besides, several large areas of the west, east, and south are completely deprived of the benefits of regional banks in stimulating business activity in the region, financial support for promising projects, and regional development programs. This fact is also confirmed by the research of other domestic scholars [8, p. 12; 9, p. 130].

All of the identified fifteen regional banks belong to the group of banks with private capital. As of January 1, 2021, their share is about 20% of the total number of credit institutions of the banking system of Ukraine. However, the qualitative role of regional banks in the functioning of the regional economy is quite insignificant. The share of total assets, liabilities, and equity of regional banks is about 1%, 2%, and 3% respectively.

Along with this, the financial position of regional banks is characterized by greater stability than the average in the banking system. Thus, the average value of the share of equity in the assets of regional banks (the

main indicator of financial reliability of the credit institution) is more than 30%. At the same time, it is about 10% in the banking system of Ukraine as a whole.

Regional banks have a balanced credit policy, as evidenced by a moderate level of overdue debt. Regional banks accumulate about 2% of the total funds of business entities and non-bank financial institutions in their accounts. The value of the individual share is even smaller – about 1.5%.

Unlike large systemically important banks, regional banks are mostly focused on an individual approach to each client, flexibility, and the benefits of close relationships, providing more convenient and secure means of payment [9]. The main source of funding for regional banks is deposits of residents [10]. Based on personal trust with the client, the history of the relationship with the client, and a deep understanding of the needs of the local business, regional banks can be more competitive and attractive for many groups of clients. It is no coincidence that there is a positive correlation between the existence of regional credit institutions and the economic growth of the regions [11]. Regional banks play a special role from the standpoint of forming the image of the region as a territory of business development, high business activity, the formation of strategic business areas, etc. [12, p. 103].

Traditionally, regional banks have become the main partners of small and medium-sized businesses, and some large industrial producers operating in the region. The swiftness of decision-making is one of the main competitive advantages of regional banks. Regional banks, in contrast to large systemically important banks, are mostly focused on the specifics of the local clientele and are more sensitive to the needs of regional businesses and the population.

It is no coincidence that the successful regional economic policy of the United States and Germany has always been based on the regional principle of banking, which means that the binding of agreements involving commercial banks coincides with the region of their founders' location. In the above-mentioned countries, conditions are legislatively created for the successful operation of local banks for the benefit of the population of specific territories (states, lands, cities, etc.).

Thus, 67% of all US commercial banks are “state banks” with charters (licenses) issued by state governments (mostly, these are small banks). Typically, state bank branches are located within the county where the head office is located, or in a neighboring county. Strong political support has been formed for the practice, according to which regional banks are owned and controlled by persons living in the defined area [13, p. 142]. Local people often fear that the bank's branch will accumulate their savings and invest these funds in other regions. Moreover, in the United States, the supervision of regional banks is carried out by special institutions of territorial authorities, which also monitor the compliance of their activities to the economic needs of the region.

In Germany, the regional principle has always been the most important organizational feature of banking. Thus, the largest group of banking institutions in Germany today is represented by a system of municipal savings institutions, which concentrate more than 60% of the accounts of the entire population. Authorities of cities and districts act as owners of these banking institutions and thus the warranters of depositors' savings. In 2010, the group of savings banks in Germany included 431 banks, which had 15 thousand branches in all federal lands of Germany [14, p.81.-83.]. The peculiarity of municipal savings institutions in Germany (the so-called Sparkasse - German) is that the main purpose of their activities is not to make a profit and increase the value of share capital but to ensure the general welfare of the population living in the service area. Apparently, by entrusting their savings to local financial institutions through Sparkasse, German households realize that their savings will be directed to the development of their area of residence, so their economic interests will be best served.

Proponents of the regional principle of the country's banking system emphasize that its observance is a guarantee of promoting the development of the regional economy, infrastructure, preservation, and the increase in the number of jobs. Moreover, regional banking institutions (of private, municipal, and mixed ownership) compete with other credit institutions, which provides a high level of quality of banking services throughout the banking system [15].

Long-term relationships with client firms give regional banks a deep understanding of the specifics of their production process, potential economic, and other problems of borrowers. Therefore, it is natural that regional banks are more informed when they finance innovation projects of firms as they have a better understanding of the benefits of business plans for the development of new technologies.

Improvement of the banking regional system requires the government to provide some support to regional banks in terms of the expansion of the large state, as well as foreign banking structures. Such support should include a special approach in determining the benchmarks for the management and performance of regional banks by banking supervision and regulation, as well as the introduction of programs to promote faster technological re-equipment, considering the active spread of modern technologies – artificial intelligence, blockchain, biometrics, 5G, AR / VR, quantum computing, etc. Shortly, mobile payments will be replaced by voice commands and biometrics. Thanks to the “Internet of Things”, any device can become a digital channel for paying for goods and services. Moreover, as regional banks may not objectively have the resources that large banks have to make a faster transition to the use of new technologies, the state needs to assist them technologically in a centralized way. Currently, it is becoming an important factor in achieving efficient activities of regional banks, and thus promoting the formation of a more competitive environment of the banking system of Ukraine with a wide range of banking services.

It is believed that the NBU's policy of supporting regional banks in terms of monopolization and increasing the concentration of the country's banking market prevents banks from competing and becoming stronger and may even reduce the efficiency of financial resources in the economy. However, this viewpoint is not entirely true, as it contradicts the established foundations of economic theory concerning the obvious advantages of a market structure close to a market of perfect competition when banks should compete mainly in terms of quality customer service and not in terms of their quantitative values.

Moreover, the state should encourage the creation of local cooperative banks, which may include local authorities as their members. Thus, the experience of Switzerland shows that municipal banks have a higher level of control by the community, in particular, provides a transparent anti-corruption policy on financial transactions of local governments, and most importantly – active credit support for local business development, especially when it comes to the formation of research centers and clusters [16].

It is also useful to study the practice of using the opportunities of the Regional Development Bank. A good case is a German experience of using a regional bank as a regional development intermediary – the activities of the Bavarian Development Bank (LfA Förderbank Bayern – German), founded in 1951 to finance the recovery of the Bavarian economy after the war. The Bank is owned by the Government of the Free State of Bavaria, is a specialized development bank of the Free State of Bavaria, and provides loans to businesses exclusively within the territory of Bavaria. The bank provides loans on the principle of a “home” bank, has a relatively small staff, about 300 people, and, thus, provides a low level of costs. Following the German Banking Act, the Bavarian Development Bank is under the supervision of the Federal Financial Supervision Authority of Bavaria [17, 18].

Since its foundation, the Bavarian Development Bank has issued more than 420,000 loans totaling about 73 billion euros. Today, the bank specializes in providing financial support to regional clusters in almost all industries aimed at improving the economic, transport, energy, and environmental structure of Bavaria. The focus of the Bavarian Development Bank is on financing investment projects for those who want to start their own business and are small and medium-sized enterprises as defined by the European Commission. Such support is aimed at refunding the costs faced by smaller firms compared to larger firms. The purpose of such activities of the bank is to create new and preserve current jobs in Bavaria.

This bank operates alongside a whole group of other large credit institutions that specialize in the functional nature of the various challenges the borrowers may face. A feature of the Bavarian Development Bank is the financing regional companies in the following areas: the needs of their start-up, growth, innovation, energy-saving and environmental protection, stabilization of their financial position, support for the development of the municipal infrastructure, and financing their domestic and international orders through contractual guarantees. A study of the terms for providing the bank's financial support shows that they have several advantages and are extremely favorable.

The creation of regional development banks will be an important factor in accelerating the social and economic development of certain regions of Ukraine. Along with the municipal form of ownership, such a bank could be organized within the private form of ownership, provided such status is granted to an existing stable regional commercial bank that is aimed at corporate lending and has some experience in implementing innovation projects with various industrial enterprises.

The area of responsibility of the regional development bank should primarily include the selection of priority projects for innovation development of the region, the issuance of loans, and the organization of further monitoring of the use of credit funds. Such a bank must have an impeccable business reputation confirmed by the NBU, local authorities, business structures, and the population of the region. A high level of corporate culture and responsibility must be a hallmark of such a bank.

The municipal authorities supported by the Government and the NBU should elaborate a program to stimulate the development of the regional development bank. The program should include preferential refinancing terms, subsidizing lower interest rates, providing special state guarantees on loans, and more.

Regional banks should become supporting financial institutions for both regional business and local governments to provide guarantees for increasing the region's resources, accumulation of a significant part of the financial and credit regional resources, efficient allocation of resources to the regional economy, including regional and municipal programs. Thus, the existence of a regional banking system is one of the stimulating factors of competition in the banking market, prompting all commercial banks to improve the portfolio and quality of banking products, to reduce fees and interest on them, expand the customer base, and optimize daily operations, including IT technologies [19, p. 379-380; 20].

In the Law of Ukraine “On Banks and Banking” along with the legislative definition of the foundation and operation of foreign banks, it is important to secure the status of the Regional Bank and the Regional Development Bank, as well as prescribe certain areas to support regional banks.

The system of organizational and economic measures to ensure the development of the regional banking system should include the elements as follows: creating necessary legislative, resource, and organizational prerequisites for the formation of regional (municipal) banks by local authorities; ensuring the priority membership of regional banks in the programs of state and municipal loan guarantees for small and medium enterprises in the region; complying with the priority of involving regional banks in the implementation of the Regional Development

Strategy; improving the antitrust legislation to ensure fair competition in regional banking markets by the NBU and other special government agencies; promoting the efficiency of the NBU refinancing system and expanding access to it by regional banks, especially regional development banks; some reduction in reserve requirements for regional banks; subsidizing interest rates of certain groups of borrowers (industry and agriculture) of regional banks by the Government.

### Conclusions

Thus, the study showed that the regional banking system of Ukraine has undergone a significant reduction in recent years and has a very small share of assets, liabilities, and capital in the total banking system of the country. Most regions do not have their regional banks at all. Today, more than half of the total number of operating regional banks belongs to the Kyiv oblast and the city of Kyiv.

The activities of regional banks show that every year, it is more and more difficult for them to withstand the price pressure from systemically important domestic and foreign banks. It is increasingly difficult to comply with some economic standards set by the National Bank, the terms of financial monitoring, and compliance control. Unfortunately, the NBU does not consider the importance of having a regional banking system and ensuring balanced social and economic development of Ukraine's regions but focuses on implementing the recommendations of supranational financial regulators, which are detrimental to small regional banks, many medium and small enterprises of the real sector of the economy, and the economy as a whole.

Domestic and international practices show that bank loans can be more effective in promoting the development of an innovative economy in the regions if they are issued to enterprises the banks have close and long-term mutually beneficial cooperation. Accordingly, we can consider the significant role of regional banks in stimulating the social and economic development of the regions of Ukraine. However, under current conditions of monopolization of the Ukrainian banking system, regional banks can be competent entities of the modern banking system only provided with the support of the NBU and local authorities.

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Paper received : 03.08.2021

Printed : 04.10.2021