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# THE ECONOMIC SECURITY OF ENTERPRISES IN THE LUHANSK REGION IN CONDITIONS OF POST-CONFLICT TRANSFORMATION

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**Abstract.** *The purpose* of the paper is to research and present economic security of enterprises in Luhansk region (eastern part of Ukraine) and perspective of future threats for such enterprises in conditions of post-conflict transformation in the East of Ukraine. *Methodology.* The survey is based on a comparison of official statistic data on state and regional level (Luhansk region, Ukraine) for last 4 years (2013–2016) that cover a period of post-conflict transformation in the East of Ukraine, identifying with method of scenario analysis and expert method the main threats to enterprises of Luhansk region and their effects. *Results* of the survey showed that economic post-conflict transformation in the East of Ukraine has a great negative effect both on the national economy of Ukraine and its economic security. At the macrolevel, such economic post-conflict transformation caused a significant decrease of export and import operations, salaries, enterprises personnel, and quantity of economic agents that have any economic activity in Luhansk region. Last 2 years, some positive changes are identified. But they do not have a trend character. At the microlevel, such economic post-conflict transformation is characterized by decreasing production and capital investments. Post-conflict transformation in the East of Ukraine caused to emerging specific threats for enterprises in Luhansk region. Such threats are identified and described. *Practical implications.* Identifying economic trends in Luhansk region as the results of post-conflict transformation in the East of Ukraine is useful both for improving state regulation and support for the economy. Ukrainian enterprises using information about identified threats are able to become ready to neutralize such most critical threats to prepare for them or to avoid them to diminish their impact on enterprises activity. *Value/originality.* Described dynamics of economic indicators of Luhansk region during last 4 years comprehensively show the depth of negative changes of economic security of enterprises in the Luhansk region in conditions of post-conflict transformation in the East of Ukraine. Identified threats that emerged in conditions of post-conflict transformation in the East of Ukraine are specified and described.

**Key words:** enterprise, post-conflict transformation, economic security, threat.

**JEL Classification:** D22, H56, M21

## 1. Introduction

Since the 90s of the 20th century, the category of economic security has become one of the most fundamental categories in modern national and international economics. Economic security is of great interest to scientists at its all levels “state – region – enterprise”. This is due to the fact that economic security is the most important element of national security and provides competitiveness of the national economy. Exactly the achievement of independence of Ukraine, the emergence of market economy and

protection of economic interests at the state level and the level of economic entities to a certain extent served as the starting point for the development of this scientific direction. The process of understanding of security and consolidation of its importance at all levels in Ukraine was also followed by the creation of legal documents. In particular, Article 17 of the Constitution of Ukraine (Constitution of Ukraine) states that economic security is the same important for a person, society, and state, and ensuring the economic security of Ukraine is considered to be the

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most important function of the state, of all Ukrainian people, especially in the state of armed conflict on the territory of our state. Ensuring economic security of the country is not a prerogative right of a separate state department or agency. It should be supported by a whole system of state bodies and economic structures that are acting nowadays. As a separate category, economic security is considered at the level of an individual enterprise. The analysis of the issues of economic security at the enterprise level is important as an enterprise as a social-economic system plays a significant role in ensuring competitiveness and is a prerequisite for achieving and maintaining state financial results of activity not only of an individual enterprise but also providing stable development of the national economy of any state as a whole. The role of economic security of an enterprise as an economic category becomes even more serious in the conditions of complex post-conflict transformations that are the results of geopolitical crises. An example of such a situation is the activity of the enterprises of Luhansk region (the East of Ukraine) in the conditions of post-conflict transformation. Recently the situation in the East of Ukraine is characterized by the fact that post-conflict transformations lead to structural transformations in enterprise and in the economy of the region as a whole. Such transformations are challenging and threatening for the economic security at all levels – from a separate enterprise to the national economy – and need to be analysed, at least as a negative example, to prevent the repetition of similar situations.

## 2. Research Methodology

Methodological basis of the article is the set of methods of scientific knowledge, general methods, techniques, and principles. The statistical method and the method of scenario analysis were used to obtain the results of the research. The theoretical basis of the work is the fundamental provisions of economic security science and the theory of an enterprise.

Figures for the formations of the provisions and results of the study were based on the statistical data, in particular, data of the State Statistics Service of Ukraine (Main administration of statistics in Ukraine: the Official site; Main administration of statistics in Luhansk region: the Official site; Ministry of economic trade and development of Ukraine: the Official site; Gross Domestic Product of Ukraine, structure and dynamics), reports and documents of state authorities in Luhansk region (Strategy for Development of Luhansk region; Strategy for Development of Luhansk Region until 2020, 2016), reports of the international organizations operating in Ukraine (Website of World Bank).

## 3. Results

### 3.1. Ensuring the economic security as a prerequisite for sustainable development

The world experience shows the fact that even when the development of the economy was without ensuring its security (Brazil in the 60s, Egypt and Poland in the 70s, Mexico in the 80s, Turkey, Thailand, Indonesia in the 90s of the 20th century; Argentina at the beginning of the 21st century), it was quite unstable, and the period of economic growth lasted not so long and ended with the economic crisis (Humeniuk, 2014). A. M. Humeniuk states that economic security is the dominant or at least the most important characteristics of the economy, and the aim of economic development, in this case, is to ensure its security (Humeniuk, 2014). However, it is not right to fully agree with such point of view, as the absolutisation of economic security leads to the preventing of the development of the economic system, which is presented in the paper (Ljashenko, 2008). Economic security is connected with development, ensures its sustainability, but there is no reason to absolutise economic security. Security is essential for the functioning and development of the economic system, and the development of the economic system creates prerequisites for its security (Mojsejenko, Marchenko, 2011). S. V. Kavun considers the close connection between economic security and the development of an enterprise. In his opinion, economic security of economic entities provides stable development, balanced and permanent, which is achieved through the use of all kinds of resources and opportunities, which guarantees the most effective their usage for stable functioning and dynamic scientific and technical, social development, prevention of internal threats (Kavun, 2009).

However, after a certain level, the effort to ensure the economic security of a particular system hinders its development and even prevents positive changes, becomes the inhibitor of development and creates particular threats. Paradoxically, but the very attempts to ensure the economic security of a particular system becomes the factor of the decreasing of such security since it constrains the system, restricts its adaptive reactions and the introduction of even positive changes. After all, if one understands security only as safety, it turns out that the development of the economy is complete. Such an approach means that the functioning of any economic system will have a digression character. In this case, at the macro level, the international economic relations will be formed between the states, which have secured the national economy or will continue to weaken until they are fully terminated. The very concept of economic security is quite complex. On the basis of (Lynnyk & Artemenko, 2013; Zubok, Rubcov, Jaremenko, Ghusarov & Chernov, 2012; Prus, 2014; Kozachenko, 2015), it is arguable that nowadays

there is a set of approaches to the explanation of economic security. They are protective, competitive, procedural, harmonious, and so on. Each of them has its own argumentation and can be used to explain economic security. Economic security as a category in general has an attributive character and characterizes state, needs, conditions of activity at an enterprise (Illjashenko, 2016).

For an enterprise, economic security is one of the fundamentally important categories of its activity. Its absence can prevent from achieving positive financial results of an enterprise (for example, in case of armed conflict as a threat) and also affect the ability of long-term operation of an enterprise. But taking into account that an enterprise is an atomic agent of any national economy, the category of national security is vitally important not only for a separate enterprise but also for a region and a state, as the absence of economic security can influence negatively the functioning of the economic system as a whole. Consequently, the economic security at all levels, from an individual enterprise to the whole state, is the important condition for sustainable development and the prerequisite for long-term functioning.

### 3.2. The main macroeconomic conditions of activity of enterprises of Luhansk region

Events on the territory of the Crimean peninsula since the beginning of 2014 and the armed conflict in the south-eastern regions of Ukraine are those transformational processes at the macro level, which completely change the operating conditions of enterprises in Luhansk and Donetsk regions. Such challenges and threats in Ukraine need the research of the consequences for the economic security of regional enterprises and the issues of its ensuring. Such events led to the formation of the post-conflict transformation at all levels of the Ukrainian economy. In this case, the post-conflict transformation is proposed to understand

as the adaptive reaction of the Ukrainian economy at all its levels to armed conflict in the south-eastern regions of Ukraine in the form of processes (often degradation) of changes in production, the location of production capacities, capital investments, etc.

In the result of loss of control over the certain parts of Donetsk and Luhansk regions (that is almost 25% of the economic potential of Ukraine (Ghorbulin, Vlasjuk, Libanova, Ljashenko, 2015), the cumulative economic losses of Ukraine in the period of 2014–2016 exceeded 50% of GDP (Main administration of statistics in Ukraine: the Official site; Ghorbulin, 2017). The loss of control by the Ukrainian authorities has led to the significant structural shifts in the economy of these regions and Ukraine as a whole, which also declines the level of economic security, the reduction of solvent demand, and the decline of the industrial sector.

In such conditions, there was a substantial, almost half decrease of the role and the place of Ukraine in the world economy. In 2015, the share of Ukrainian GDP in world GDP reduced to half its amount compared to 2013, – to 0.12% and by 2.5 times compared to 2008 (0.26% of world GDP) (Figure 1) (Main administration of statistics in Ukraine: the Official site; Gross Domestic Product of Ukraine, structure and dynamics; Website of World Bank). The decline in the Ukrainian economy was accompanied by a dramatic decline in its export potential and, according to the results of 2015, Ukraine's commodity export amounted to 0.23% of world exports, what is 1.5 times and 1.8 times less than in 2013 and 2008 (Ghorbulin, 2017). According to the expert estimates of the National Institute for Strategic Studies, losses of the consolidation budget in the result of the annexation of Crimea and the occupation of the Donbas region during 2013–2014 are about 5 billion dollars, in particular, 4 billion dollars in tax revenues (Ghorbulin, Vlasjuk, Libanova, Ljashenko, 2015, p. 162).

Direct investments in Ukraine began to fall before the events of 2014. In 2013, foreign direct investments

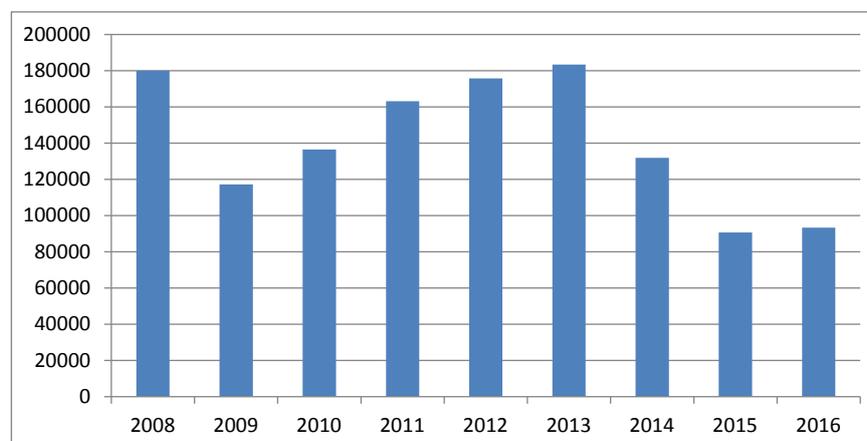


Fig. 1. Nominal GDP of Ukraine from 2008 to 2016, million USD

Source: created by the author, based on The World Bank 2016 (Website of World Bank)

were reduced by 46.4% from 8.4 billion USD in 2012 as a result of a reduction in demand for Ukrainian exports, worsening of the political situation and economic uncertainty in Ukraine. Similar fall of global investment flows was in 2009 as a result of world financial crisis. Then foreign direct investments in Ukraine were reduced by 56%. However, the fall of foreign direct investments in Ukraine by more than ten times in 2014 became unprecedented both in the history of Ukraine and in comparison with neighbouring countries. Even taking into account the growth in 2015 (2.96 billion USD) and during the 6 months in 2016 (2.13 billion USD), foreign direct investments haven't still reached the level of 2013 and all the more the level of 2012 (Direct investments in Ukraine: war and peace). In addition, this growth is largely due to the capitalization increase of banks with foreign capital (Tarasenko, 2017, p. 184-185). Consequently, both GDP figures and the indicator of foreign direct investments in Ukraine during 2013–2016 showed steady negative dynamics.

Negative economic processes, high level of threats, challenges, and a large number of issues in the Ukrainian economy affect the level of economic security insurance in Ukraine (Figure 2). According to the Methodological Recommendations for calculating the level of economic security in Ukraine, approved by Decree of the Ministry of Economic Development and Trade of Ukraine No. 1277 on October 29, 2013 (Methodological recommendations for the calculation of level of Ukraine's economic security, 2013), the integral indicator of economic security should stay at the level of 60–79% that is satisfactory zone of economic security. It should be noted, that the level of economic security was below the corresponding level before the beginning of military activities in the East of Ukraine, but with the beginning of such actions, it continued to decrease.

### 3.3. The activity of enterprises in Luhansk region in the context of post-conflict transformation

Based on the dynamics of macroeconomic indicators of Ukraine during 2013–2016, it is possible to make a preliminary conclusion about the difficult conditions of functioning of domestic enterprises, and the enterprises of the Luhansk region in particular. Such complex conditions further deteriorate structural features of the economy of the East of Ukraine. As it is stated in the State Strategy of Regional Development for the Period up to 2020, approved by Decree of the Cabinet of Ministers of Ukraine dated August 6, 2014 No. 385 (State Strategy of Regional Development for the period until 2020, 2014), backward technology base and industry's monofunctionality in Donetsk and Luhansk regions, raw materials nature of export and its focus mainly on the Russian market conserve the imperfect structure of the economy, dependence on external markets, particularly energy resources. State industrial policy, which was based on preferences for specific territories and companies in the coal and steel industry, did not enhance the competitiveness of these regions. Policies of local authorities have led to the closed nature of the regional markets and their actual integration into the Russian market. As a result, in addition to the economic problems of these regions against the background of relatively high average wages compared to other regions, there increased intra-regional disparities with regard to the development of infrastructure, public services in education, culture, health, environment, and others. Developing are mainly regional centres, and mining and rural areas are in decline. The result of these trends is a significant stratification of the population by income, unemployment, the social discontent of residents in the regions, the creation of grounds for separatism manifestations (State Strategy of Regional Development for the period until 2020, 2014).



**Fig. 2. Dynamics of the integral indicator of the level of economic security of Ukraine in 2011–2015, %**

Source: according to the Ministry of Economic Development and Trade of Ukraine (Ministry of economic trade and development of Ukraine: the Official site; Boghma, 2016)

According to the Luhansk Region Development Strategy for the Period until 2020 (Strategy for Development of Luhansk Region until 2020, 2016) the strategic goal for the development of the region is the rehabilitation of the economy and sustainable development. The economic development, in its turn, depends on the extent, to which business entities are capable of producing competitively viable on world markets production and is able to provide an appropriate level of economic security. Today's situation requires enterprises to implement modern instruments for the protection of their activity. Ensuring the economic security of each enterprise becomes one of the main goals of managing enterprises and the region as the most important elements of national security.

The sharp deterioration in the region's economic situation (except objective factors) resulted from the unbalanced development of its northern and southern districts. The government-controlled area contains 25.9% of the total number of industrial enterprises, mainly engaged in the production of chemicals and chemical products, refined petroleum products, paper and paper products, and mining, as well as small enterprises producing textiles, clothing, and food products. The major industrial enterprises are located in Severodonetsk city, Rubizhne city, Lysychansk city, Kreminna city, and there are agricultural companies and small food processing enterprises in the northern parts of the region. Machine building, metallurgical production, fabricated metal products enterprises, and enterprises engaged in extracting anthracite thermal coal remained in the non-government controlled area. Some industrial enterprises (such as Alchevsk Metallurgical Plant Private Joint Stock Company) re-registered in the government-controlled area, submit the statistical and tax reporting under Ukrainian legislation, and pay taxes to the appropriate budgets, but their production facilities remain in the temporarily occupied territory (Strategy for Development of Luhansk Region until 2020, 2016).

Prior to the anti-terrorist operation, Luhansk region had significant economic potential and was one of the five strongest industrial and economic regions in Ukraine. In the context of the general economic crisis, the armed conflict in Eastern Ukraine has significantly worsened the economic situation in Luhansk region for January-December 2015 compared to January-December 2014:

- industrial production index fell by 66% (in Ukraine as a whole it fell by 13.0%);
- agricultural production index fell by 19.6% (in Ukraine by 4.8%);
- capital investment declined by 73.9% (in Ukraine by 1.7%);
- the volume of exports reduced by 86.4% (in Ukraine by 29.3%);

- foreign direct investment declined by 13.2% (in Ukraine by 5.5%) (Main administration of statistics in Ukraine: the Official site; Strategy for Development of Luhansk Region until 2020, 2016).

The negative dynamics of economic indicators in Luhansk region is even greater than in Ukraine as a whole. Figure 3 shows the dynamics of foreign trade in Luhansk region in recent years.

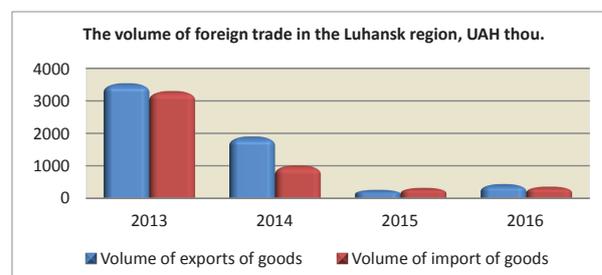


Fig. 3. The amount of foreign trade in Luhansk region

Source: created by the author, based on State Statistics Service of Ukraine. Retrieved December 1, 2016, from <http://ukrstat.gov.ua>

It is clear that since the beginning of the armed conflict in the East of Ukraine, the amount of import and export has reduced greatly. For a more detailed analysis of the post-conflict transformation of Luhansk region's economy, we will analyse some of the quantitative indicators of the functioning of enterprises in this region and compare periods before the beginning of armed conflict till the present time (Table 1).

Data analysis in Table 1 allows us to conclude that in the result of the armed conflict, which has taken place for more than three years in the Luhansk region, all the main indicators of activity of enterprises have reduced by almost three times. The number of enterprises in Luhansk region before and after armed conflict has been decreased by 71.6%. Since 2015, there has been a post-conflict transformation of the economy and a slight growth nearly by 9% over two years.

In 2015, the gross regional product of Luhansk region fell to 14079 UAH per person (Main administration of statistics in Luhansk region: the Official site), which is the lowest index among all regions of Ukraine. According to the results of the monitoring of the socio-economic development of regions of Ukraine, Luhansk region took the 24th place by 12 complex indicators, which is the last but one (Strategy for Development of Luhansk Region until 2020, 2016).

Table 1 shows the dynamics of the enterprises of all branches, but it is necessary to study the production itself. As of 01.01.2016, 489 industrial enterprises operated on the territory under the control of the Ukrainian authorities, (48.0% of the total number of industrial enterprises before the beginning of the anti-terrorist operation): 9 large enterprises, 99 medium enterprises and 381 small enterprises (Strategy for Development of Luhansk Region until 2020, 2016);

Table 1

**The main indicators of the activity of enterprises in Luhansk region**

	Indicators of the activity of enterprises	Year				
		2012*	2013*	2014**	2015**	2016**
1	Number of enterprises, entities	10732	11385	3233	3354	3526
2	Amount of sold products (goods, services) of enterprises, million UAH	117310,4	104236,0	45796,5	34583,9	48333,1
3	Number of employees employed at enterprises, thousand people	357,2	335,9	130,2	111,9	104,4
4	Number of employees at enterprises, thousand people	354,1	332,8	129,2	110,9	103,3
5	Labour costs, million UAH	117344,9	127348,7	6205,1	5033,1	5671,3

Note:

\*Data are given excluding the results of the activity of banks and state-financed establishments, excluding the change of the main type of economic activity at enterprises.

\*\*Excluding the results of activity of banks, state-financed establishments and the part of the area where the anti-terrorist operation is being conducted.

Source: created by the author, based on State Statistics Service of Ukraine. Retrieved December 1, 2016, from <http://ukrstat.gov.ua>

Main administration of statistics in Luhansk region: the Official site).

The industrial production index in Lugansk region in January-December 2014 compared to the corresponding period of 2013 was 58.0%. The index of industrial production in Luhansk region in January-December 2015 compared to January-December 2014 was 34.0%. The amount of industrial products sold in Luhansk region in January-December 2014 was 45.4 billion UAH, which is by 22.3 billion UAH less than in the corresponding period of the previous year (67.7 billion UAH). In the national amount of sold products, this indicator is 3.8%, for which the region ranks 8th among the regions of Ukraine (in 2013 – the 5th place). The amount of industrial production sold in January-December 2015 was 24.8 billion UAH, which is 1.7% of the national economy (Strategy for Development of Luhansk Region until 2020, 2016; Main administration of statistics in Luhansk region: the Official site). Consequently, based on these data, it is possible to make a conclusion not only about the negative dynamics of absolute indicators of enterprises in Luhansk region but also about the significant structural changes in the Ukrainian economy as a consequence of the post-conflict transformation in Ukraine.

### 3.4 Modern threats and risks to the economic safety of enterprises in Luhansk region

It is clear that the situation that has taken place in the East of Ukraine negatively affects the economic security of enterprises, causes new threats and challenges to them. It is necessary to study such threats and challenges, their nature in order to enable Ukrainian enterprises to resist them and to maintain the state of economic security. Generally, the threats to enterprises are divided into general and specific. General threats (saturation of the market, illicit mergers and acquisitions, resource shortage, etc.) are well-known and do not call for further study. Therefore, it would seem advisable to

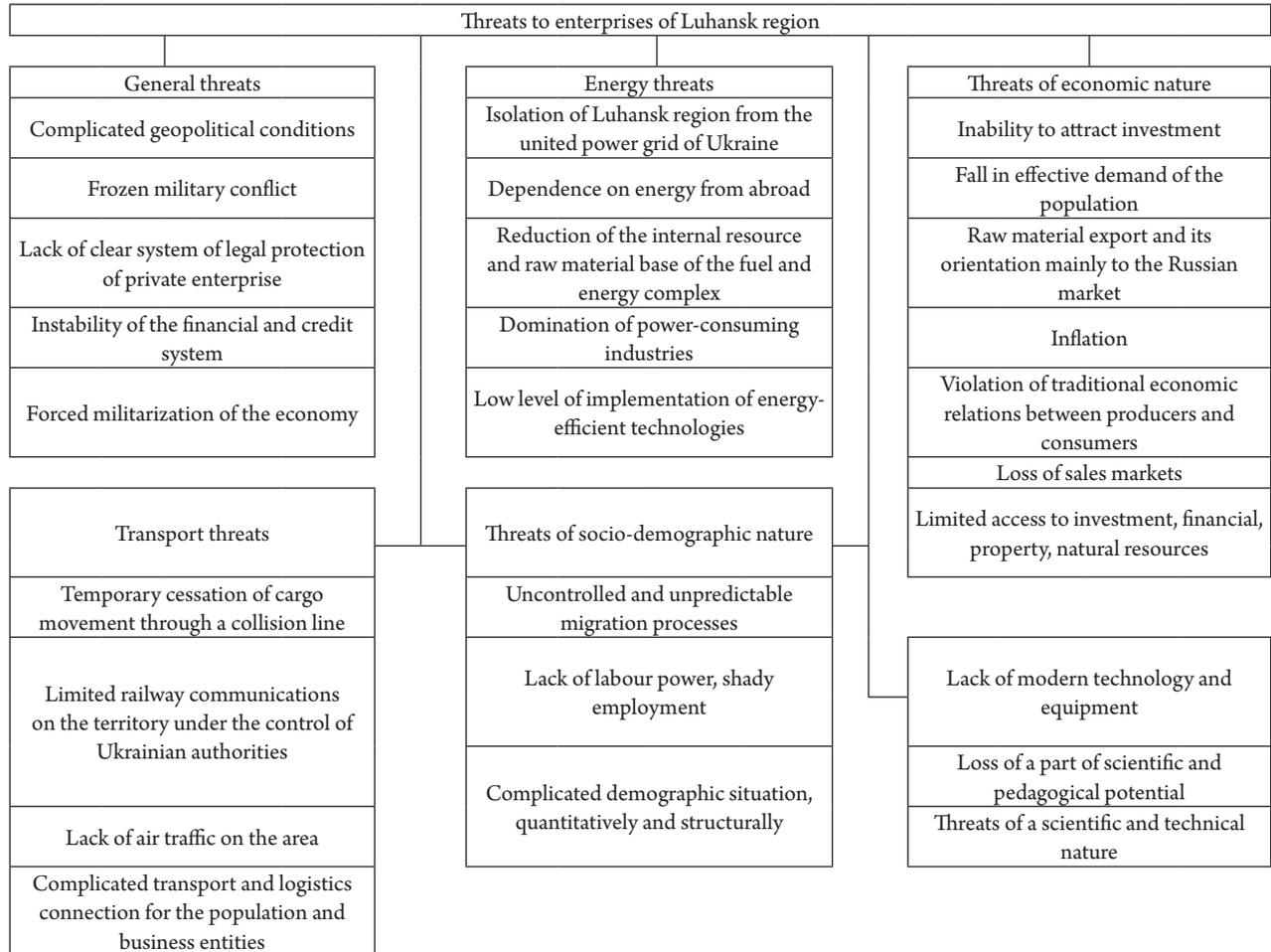
study specific threats to enterprises in Luhansk region in the context of post-conflict transformation. Figure 4 shows such threats.

The presented threats are based on the scenario analysis and the expert survey method. The respondents are middle and top management executives of the enterprises located in Luhansk region. The group of experts is 37 people from 16 middle and large enterprises of different industry affiliates. The survey was conducted during the 3rd quarter of 2017.

It is necessary to describe the following groups of threats to enterprises of Lugansk region in the context of the post-conflict transformation in order to determine measures, which are necessary to be taken by the enterprise to overcome such threats as a maximum and, as a minimum, to determine the principal plan of actions of the enterprise. Such a description of some groups of threats is shown in Table 2.

Commenting on Table 2, it should be noted that there is no opportunity for Ukrainian enterprises to resist the impact of most of the mentioned threats and the only one plan of actions is the adaptation to new operating conditions. At the same time, the impact of some of these threats is possible if not to resist but to reduce by the certain plan of actions of the enterprises.

In order to secure the enterprises of Luhansk region from the impact of such threats, it is proposed to pre-determine the plan of actions at the level of each enterprise on the basis of the tuple. For this matter, it is convenient to use such a tool as a tuple in the form of  $Sc = \langle Thr, Act, Subj, Res \rangle$ , where  $Sc$  is a plan of actions of an enterprise to resist certain threats or to reduce their impact;  $Thr$  is a description of a certain threat, which is defined empirically, based on scenario analysis or expert survey;  $Act$  are specific actions of an enterprise in response to a certain threat;  $Subj$  is a subject of action from the number of managerial bodies in an enterprise who will directly deal with the neutralization of the identified threat or the reduction of its impact;  $Res$



**Fig. 4. Threats to enterprises of Luhansk region in the context of post-conflict transformation**

Source: created by the author, based on (Strategy for Development of Luhansk Region until 2020, 2016; Lynnyk, Artemenko, 2013; Ghorbulin, Vlasjuk, Libanova, Ljashenko, 2015; Ghorbulin, 2017; Tarasenko, 2017)

**Table 2**  
**The description of the main threats (groups of threats) to enterprises of Luhansk region in the context of the post-conflict transformation**

Group of threats	Nature of impact	The possibility of an enterprise to resist the impact of threats	The level of negative impact on the activity of enterprises in the current period	The main plan of actions
General threats	Long-term	Absent	High	Adaptation
Energy threats	Long-term	Absent	High	Adaptation, technical re-equipment, implementation of energy-efficient technologies
Threats of economic nature	Medium-term	Absent	High	Search for new markets, reorganization of production
Transport threats	Medium-term	Limited	Medium	Search for new logistics routes
Threats of socio-demographic nature	Long-term	Absent	Medium	Adaptation
Threats of a scientific and technical nature	Medium-term	Limited	Low	Search for resources in other regions of Ukraine

Source: suggested by the authors

are necessary resources of different nature (financial, human, technical) to respond to the threat and sources of obtaining such resources by an enterprise. Defining of the plan of actions for enterprises in Luhansk region in the context of post-conflict transformation will not allow resisting all threats, but will allow preventively identifying the necessary actions for responding to such threats and positively affect the economic security of such enterprises.

#### 4. Conclusions

Economic security at all levels – from the individual enterprise to the national economy, is an independent important category which is essentially linked to sustainable development.

It has been shown that the armed conflict in the East of Ukraine led to negative economic consequences both at the level of economy of Ukraine as a whole and of the economy of Luhansk region during 2014–2016. Although recently economic indicators of Luhansk region have improved due to post-conflict transformation, the general situation of the economy of Luhansk region in the context of the conflict in the

East of Ukraine remains negative. In the context of the post-conflict transformation, the enterprises of Luhansk region have substantially reduced the main indicators of their economic activity. The economic security of the enterprises of Luhansk region has been decreased, as well as a result of actualization of threats. Such threats have specific nature and arose as the result of the post-conflict transformation in Ukraine. The main threats to enterprises of Luhansk region, which negatively affected their economic security, are general threats, energetic, economic, transport threats, and threats of socio-demographic and scientific and technical nature.

For an individual enterprise of Luhansk region, some of these threats are unsustainable and the only one way for such enterprise is an adaptation. However, it is possible to reduce the negative impact of some threats. For this matter, it is proposed to develop a plan of actions in the presented tuple form, which are aimed at reducing the negative impact of a particular threat. To resist a significant number of threats to enterprises of Luhansk region, the actions of the government are necessary, and without them and without normalization of the situation in the East of Ukraine, such threats remain actual and unsustainable for each individual enterprise.

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