

Review Paper

Methods of Improving the Management and Evaluation of Investment and Entrepreneurial Activity in the Republic of Artsakh, Considering Newly Emerged Economic Risks

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ABSTRACT

The study is devoted to the issues of economic risk management in investment activities in modern conditions of entrepreneurship development. Methods of theoretical cognition are used to achieve this goal, namely methods and techniques for the study of information and analytical materials (synthesis of a problem situation, problem analysis, extrapolation). Methods of structural-logical analysis and the method for comparing analytical data and summarising the collected analytical information of research materials are applied to identify structural elements and systematise risks characteristic of the Nagorno-Karabakh Republic (NKR). The paper focuses on aspects of political and country risks, the impact of external and internal factors on the implementation of investment and entrepreneurial activities. The issues of both real and financial investments are touched upon, and, accordingly, the issues of increasing economic risks associated with them. That is why there is a need to implement a methodology for systematic assessment and management of investment risks, which will consider all the factors of influence of the external and internal environment inherent in the conditions of implementation in the Republic of Artsakh, adopted and approved at the level of the Ministry of Economy and the Ministry of Urban Development. It is proposed to create a new management body – the Artsakh Investment Risk Management Society, which will fully assume the function of controlling the entire process, starting from the conception, planning and up to the implementation and liquidation of investment projects and programmes.

HIGHLIGHTS

- The article aims to explore economic risk management in investment activities, particularly in the Nagorno-Karabakh Republic (NKR), by applying theoretical methods and analytical techniques to identify and systematize risks, focusing on political and country risks, and proposing the establishment of the Artsakh Investment Risk Management Society to oversee investment projects and programs.

Keywords: Entrepreneurship Development, External Environment, Financial Resources, Market Relations, Particular Investment

Investment and entrepreneurial activity at all levels of development and management of national policy are always inextricably linked with risk. Risk becomes part of the economic policy of the state. The degree of risk increases with the level of uncertainty of the state of market relations in the country (transition period, military operations, disasters, pandemics). In the modern world, the

increase in the degree of risk is associated with the speed of changes in the level of uncertainty and changes in economic conditions in the country in which investment funds are attracted (Blank, 1995).

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Economic risk is most often understood as the level of uncertainty, i.e. the inability to predict with an accurate probability the expected efficiency from the implementation of a particular investment of financial resources (Harvey *et al.* 2021). A number of authors, including H. Bierman and S. Smidt (1960) in their papers often equate the concepts of risk and uncertainty. Others, for example P. Linneman (2022), J.R.J. Thompson *et al.* (2021), E. Krkoska and K.R. Schenk-Hoppe (2019) disagree with them and believe that risk is a separate economic category. In general, when considering the process of attracting investment funds, the concept of investment risk is distinguished. Investment risk is defined as the possibility of unforeseen financial losses (reduction of profits, losses, capital losses) in conditions of uncertainty of investment activity under the influence of external and internal factors. Therewith, factors of influence are considered not only economic but also climatogeographic (Karapetyan *et al.* 2022).

The following tasks are implemented in the study to achieve the stated goal: the conceptual apparatus of risk, political risk, and country risk is being clarified, considering the opinions of different authors and the specific features of the NKR; the characteristics of the development of investment activity in the Republic of Artsakh in the last decade are considered; the proposal to improve the management of investment activities and reduce risks through the implementation of a systematic approach; the possibility of creating a new management body – the Artsakh Risk Management Society, which will combine the functions of analysis, planning, control, and implementation of investment projects and programmes, is being developed.

The purpose of the study is to review and clarify the aspects of investment management in the Republic of Artsakh, considering the factors of influence of the external and internal environment that form the level of uncertainty affecting the increased level of investment risk.

MATERIALS AND METHODS

Methods of theoretical cognition were used in the study, namely general logical methods and techniques for the examination of analytical materials. In particular, the tools of structural-

logical analysis, comparison and generalisation of the collected theoretical and analytical information were used to clarify and specify the research methodology and adapt it to the conditions of the development of the Republic of Artsakh, concretise the terminology, define the range of problems of the issue under study more clearly. This allowed observing the hierarchy of the study adhering to the logical structure and systematising the available analytical, statistical, and theoretical data. The research methods were determined within the framework of the tasks necessary to achieve the goal set in the study. The selected methods allow identifying the main problems in the risk management of the Republic of Artsakh.

The structural-logical methods are based on the consideration of the logic of the relationship of the structural elements of the system. The structural-logical analysis of scientific publications on investment risk consisted in identifying patterns and structuring the research results of different authors. Using this method in the examination of papers investigating the problems of risk assessment, it was possible to identify those structural elements of the investment risk management system that need further clarification, detailing, and improvement.

The method of comparing theoretical data was used to systematise the types of risks for further research. The method was used in this case both to identify the characteristics of the homogeneity of risk (economic, investment) and to assess the investment activity of the Republic of Artsakh in general. In addition, during the evaluation of analytical data, it was used to analyse the state of economic indicators of the development of the market economy in general by comparing the main statistical indicators. The level of attractiveness of projects for investors consists of a whole set of indicators of the development of the country and their dynamics over the period under study. The comparison method was used as a continuation of the structural-logical method to identify problem areas in the development of systems and determine analogies in general structures, making forecasts. Using the tools of the method, comparing the indicators of economic development in recent years, it was possible to assess their dynamics and evaluate preliminary forecasts of the development of both the country and the investment climate. At

this stage, the optimal methodological tools for risk assessment are being determined, considering the specific features of the development of investment activity in the Republic of Artsakh.

The use of the method of generalisation is advisable to identify common characteristics and features of risks in the Republic of Artsakh under conditions of uncertainty. The method was used in the study to generalise the analytical and research data obtained in the implementation of the optimal solution, considering the specific features of a particular business entity. This method allows for the development of a risk management system in the Republic of Artsakh. This is especially important to realise the possibility of logically building a risk management system in a country with a high degree of financial, economic, and investment risk in the existing economic conditions. Such a system may be useful in the future both in attracting investments for a real investment project and in developing programmes to improve the investment climate of the Republic in general.

RESULTS

Economic risk objectively becomes an integral part of the economic policy of each state. In market conditions, the development of entrepreneurial activity, any type of investment, production, and other activities are invariably associated with uncertainty and factors of influence of the economic environment. Uncertainty is the unavoidable effect of the market environment on economic entities, which are due to the fact that a large number of factors of different nature and orientation simultaneously affect market conditions, for which obtaining a generalising assessment is impossible (Bierman and Smidt, 1960). Risk is most often equated with uncertainty. The very concept of risk is of Spanish-Portuguese origin and translates as “underwater rock”, i.e. danger. The existence of risk is primarily due to the inability to predict economic results from investing in projects with 100 per cent accuracy. That is why, investment or investment-entrepreneurial risk is most often researched on and highlighted.

The issues of investment risk management are always relevant, but in the Nagorno-Karabakh Republic, they began to rise especially sharply only

in the last 8-10 years, with the beginning of the recovery of the market economy (Avetisyan *et al.* 2009). From the standpoint of political economy, risk is an economic category since it is a logical concept that (Bierman and Smidt, 1960): states the truth, i.e., reflects real economic relations; is historical because it carries the features inherent in various economic establishments (Bierman and Smidt, 1960).

The ability to estimate or predict future losses from investments in an investment project by any of the existing methods means the possibility of quantifying economic risk. As a rule, the assessment of economic risk is probabilistic in nature and is associated with the probability of the occurrence of events in the market environment. These are primarily factors of the external environment and the internal environment (Marvin and Stein, 2020). Environmental factors are less manageable and are probabilistic in nature. These include political factors that form political risk, which manifests its effect in the form of changes in business conditions due to political reasons, which can lead to loss of profit. They can be divided into several types, one of which is the risk of military action. Political risk can also be divided into regional, country, and international. Country risk characterises the features of a given country. Country risk is an entrepreneurial risk in relation to one country. These risks arise when entrepreneurs and investors conduct their activities on the territory of foreign states. Quantitative assessment of country risk is important for making investment decisions in other countries (Issa *et al.* 2021).

The Nagorno-Karabakh Republic, whose official constitutional name is the Republic of Artsakh, is an unrecognised state in Transcaucasia (Avetisyan *et al.* 2009). The NKR was formed and proclaimed on September 2, 1991, by referendum. Its independence was recognised only by the Republic of Armenia (General information about..., 2023). It is located in the north of the geographical region of Western Asia and in the northeast of the Armenian Highlands. It is a small republic, with a territory of 12 thousand square kilometres, with a population of 150,932 people. This republic has a potential attractiveness for the investment market, great interest among foreign countries (mainly the Armenian diaspora) in the implementation of investment projects and programmes, but the situation with attracting

investment in the economy in recent years is unsatisfactory. One of the important reasons for this is the high risk of losses during the implementation of projects in the NKR. This is due to the political instability in the country, martial law, and the geographical position of the republic, given the economic blockade of the country (Law “On Foreign Investments”, 2023).

The independent and free, but unrecognised NKR has experienced three large-scale wars in the thirty years of its existence (1992–1994, a four-day war in 2016, and a 44-day war in 2020). The conflict between the Nagorno-Karabakh Republic and Azerbaijan has an ethnic character, which has turned violent (Avetisyan *et al.* 2009). Under these conditions, there was a decrease in risk appetite, which led to a weakening of the economy. Initially, the establishment of the Nagorno-Karabakh Republic (NKR) coincided with the transition of the economy to market relations, and the state of the national economy required the development of a fundamentally new management mechanism. The economic indicators of the NKR began to fall during the first Karabakh war, but after the war, it recovered relatively quickly and confidently. After the second four-day war, the republic lost 8 square kilometres of territories and a third of the economy. The coronavirus pandemic has also affected the economy of Karabakh. As a result of the COVID-19 pandemic, the NKR gross domestic product (GDP) decreased by 1.5% in the first half of 2020. The damage inflicted on the economy of Karabakh during the 44-day war is comparable to the GDP of the unrecognised Nagorno-Karabakh Republic. This is a loss of territories of 10 km² or 72.3%. The economy has lost most of its agricultural land and energy facilities. In addition, most of the citizens’ property – real estate, personal and agricultural equipment – was also either destroyed or removed from the control of the NKR (Avetisyan *et al.* 2009).

It is known that for the stable development of the economy, it is necessary to have a favourable investment environment, the necessary infrastructure, and a developed and managed system. It is also important to consider the situation in the world market (Draft Law “On the state budget of the...”, 2021). The consequences of the last devastating war are being overcome by solving the issues of implementing housing programmes.

The Armenian government has joined the process of reconstruction programmes by providing financial assistance to Artsakh. About 83 billion drams (170 million dollars) were allocated for the programme to support the economy of Artsakh and the implementation of rehabilitation programmes by the Republic of Armenia (General information about..., 2023). The authorities of Artsakh are gradually moving from reconstruction programmes to development programmes. The Armenian government will continue to provide assistance to Artsakh, but here the reason has changed somewhat: rehabilitation programmes have been replaced by development programmes so that the economy starts working, the labour market and economic relations are restored, money appear in Artsakh and are spent on programmes only for the development of the country’s economy.

Realising that independence is an economic category, the leadership of the republic is trying to ensure self-sufficiency in various strategically important industries. Despite a number of objective difficulties, mainly related to the non-recognition of the republic at the international level and the unresolved nature of the conflict, Artsakh manages to ensure consistent economic growth, which is mainly provided by the construction sector (Sale of agricultural products..., 2023). The investment policy is a key component of the economic policy of each country. It is based on the goal of economic development, that is productive investment activity by ensuring high indicators of national income and economic development. The NKR economy has always needed real investments. Real (capital-forming) investments (they are also sometimes called production or material) include investment in fixed assets and investments in inventories.

In the modern economy, most investments are represented by financial investments. These two forms (real and financial) complement each other, not compete. An example of such relations in the real estate sector is the financing of the construction of houses, and infrastructure facilities (Draft Law “On the state budget of the...”, 2021; Issa *et al.* 2021). After forty-four days of a devastating war, the population of the region was on the verge of a humanitarian crisis, as most of the territories (75%) were occupied, and people lost most of their agricultural land. The economy has lost energy

facilities. After the signing of the truce on November 10, 2020, the most important task for the NKR government was the restoration of infrastructure and social facilities (Law “On Foreign Investments”, 2023).

The consequences of the devastating war and the process of restoring normal living conditions are overcome precisely by solving the issues of implementing the housing programme. The Republic of Artsakh can do this mainly due to the construction sector, through the implementation of various construction programmes: construction and repair of school buildings, kindergartens, roads, water pipes (Speech by the President..., 2017; Avetisyan *et al.* 2009). At an expanded meeting of the Government dedicated to the implementation of housing programmes in the NKR, the Head of the Republic stressed that the solution to the housing problem for homeless families forced to leave their original places of residence as a result of the Azerbaijani-Turkish aggression against Artsakh, and for other vulnerable social groups, is one of the main tasks of the Government (Draft Law “On the state budget of the...”, 2021). Over the past ten years, the energy sector and the mining industry have consistently developed. Before the war, 36 hydroelectric power plants were operating in Artsakh, which met the annual constantly growing volumes of electricity consumption, and some were even exported to Armenia. After the war, out of 36 operating hydroelectric power plants (HPPs), 30 came under the control of Azerbaijan due to the loss of territories, and now only six operating HPPs remain. Since 2021, construction programmes developed by the Ministry of Economy of the NKR in various regions of the NKR are planned to be effectively implemented. For the analysis of economic risks, this document provides data on the scale of the construction industry of the republic and the construction industry in general (Statistical Yearbook..., 2023).

The need for a systematic approach is also associated with an increase in the costs of monitoring and risk management at all hierarchical levels of decision-making on the implementation of an investment project or programme. The use of investment resources (reserves), and the division of factors into manageable (regulated), conditionally unregulated (difficult to regulate) and unmanaged,

is of particular importance in the activities of construction companies. Many factors that are external constraints at the level of a construction organisation are considered manageable at the level of a ministry or government, as they are determined by the political area of the country in general and the area of economic development (for example, the amount of taxes, customs duties). The longer the period of implementation of the decision, the wider the boundaries of the difficult-to-regulate risk factors of the investment activity of the construction organisation (Linneman, 2022; Karapetyan *et al.* 2022; Barseghyan, 2019).

The rapid development of the republic and the revival of the economy, which began with a single industry – construction, influenced the development of the theory of management for both business and investment projects.

The current socio-economic and political situation in the Republic of Armenia and the NKR, the multiplicity of different risks, and the complexity of solving problems to counteract them necessitated the use of new approaches to risk management, especially at the pre-project (pre-investment) stage. The construction industry, as a type of economic activity, is influenced by factors of the external and internal environment, and hence the impact of investment and financial risks (Linneman, 2022; General information about..., 2023). The role of the state, which has been the main investor in the NKR, has increased dramatically. Budgets of all levels, with rare exceptions, take part in the investment market. The share of the state budget in financing investments is only 5-6% (Barseghyan, 2019).

Foreign investments in the economy of Artsakh in the post-war period are attracted slowly and in small volumes. Therewith, investments in the real sector of the economy are insubstantial (Draft Law “On the state budget of the...”, 2021). For the development of the production and construction potential of the Republic of Artsakh, as an unrecognised state that does not have the possibility of direct access to international markets, the stimulating function of investing in construction projects is of paramount importance, due to which there is an update of fixed assets, an increase in the organisational and technical level, the production of a construction organisation takes place, the pace of economic development and the

social status of society increases. The state is called upon as the most important subject of economic and political activity to increase investment activity and regulate investment processes in accordance with the goals and objectives, which will provide a set of conditions and tasks facing society at this stage of development. Along with a number of the most important functions of the state in the investment market, the following can be attributed to providing favourable conditions for investment and entrepreneurship, in addition to legislative functions: tax policy; depreciation policy; pricing policy; investment policy and other activities.

A lot of efforts are being made to develop the construction materials industry, which, in turn, activates the activities of the construction organisation and helps to reduce one of the most important factors in the construction industry – the time factor. The growth of the gross output of the construction materials industry in 2015 amounted to 9%, due to the revival of economic activity, which is accompanied by a change in activity in industry and production, which were focused on new technologies in the activities of construction organisations and, in particular, on the development of imports-replacement types of products. The natural resources of Nagorno-Karabakh contribute to the development of the production of building materials and structures based on local materials. Since 2001, modern technology for processing construction waste has been introduced and practised in the NKR, the final product of which is secondary (crushed stone and gravel) materials for road and asphalt concrete pavement. According to the results of the study, in 2015 there was an increase in the production of reinforced concrete and metal structures, roofing materials, and parts made of natural stone and wood. In these areas, production was constantly restructured, which was accompanied by its active modernisation based on modern technologies. With the changing economic situation and a sharp drop in demand for expensive imported products, niche manufacturers in the internal market offered construction materials that were no less competitive in price and quality. In 2019, this figure was 23%, and after the last war, it dropped again to 4% (Statistical Yearbook..., 2023). The specific features of the socio-economic environment formed in the NKR and the traditions

of individual and group economic behaviour determine the relationship between competition and risk as the driving forces of socio-economic development, which differs from that in developed Western countries. In these conditions, national risk management systems become an important tool for protecting national competitive advantages. The large number and stability of risk associations and institutions around the world indicate the fact that leading countries recognise the need to consolidate the efforts and resources of the business, science, society, and the state in this important area. Unfortunately, the NKR is still far behind in this trend. There is only one conclusion – the development of a set of measures aimed at the establishment and activation of the competitive environment as the most important incentive for investment, the implementation of antimonopoly legislation, bankruptcy laws, support for small businesses, effective depreciation and tax policy should be at the centre of national policy.

It is necessary to create a society for investment risk management of the Republic of Artsakh, the purpose of which would be planning, continuous expansion of investigation, consulting, and educational programmes for organisations in various sectors of the economy; holding regular forums, conferences, and seminars, thereby uniting the efforts of all individuals and organisations interested in reducing the tension of economic and social development in the NKR. Another important element in which it is necessary to overcome the backlog of the NKR in investment risk management as soon as possible is education, training of risk managers, and opening of an educational institution providing opportunities for education in English. This is very important for creating and strengthening further partnerships in many countries.

Today, the state should use all possible stimulating regulators in investment policy, which provide investors with a reduction in inflation, business risk, liquidity risk, risk of termination of payments, risk of changes in the market situation, purchasing power risk, interest rate risk. Consequently, the strategy of state regulation and stimulation of investment activity should meet the requirements of increasing investments in the fixed assets market and supporting manufacturers of fixed assets, which will allow resisting the trends of technical

stagnation and depression currently observed in the construction industry of the country.

DISCUSSION

The investment and entrepreneurial activity of any business entity are associated with risk. The higher the risk, the higher the expectations of profit. Investment risk is primarily a reflection of the probability of not receiving the expected financial benefits from the invested capital in the implementation of an investment project or programme, making a profit or loss from the invested capital (Zholonko *et al.* 2021). The process of implementing an investment project is influenced by many factors, and the degree of influence depends both on the specific features of the industry and the country in which the project is being implemented.

A number of researchers in their papers considered the problems of the theory of investment risk in the investment process. Thus, in the study of P. Linneman (2022), it is noted that there is no single simple solution in assessing investment risk or a single approach. The same opinion is supported by G. M. Burton (2020), indicating that this is typical for projects, both in the short term and the strategic perspective. Only a systematisation of general principles can be proposed to consider all the specific features, as, for example, in the case of the Republic of Artsakh. Over the years of independence, the construction industry has become the leading industry in the country, on the example of which the problem under study is being considered. Investment projects and programmes are being developed and implemented within the framework of the state development programme. However, in the course of their implementation, it becomes necessary to consider the factors of the external and internal environment that form the list of elements for assessing investment risks.

R. Marvin and H. Stein (2020) also pay great attention to the current analysis of the factors of the investment risk environment, with an emphasis on possible man-made disasters. However, in their study, they focus on the possibility of major accidents at work, i.e. on factors that belong to the group of controlled, predictable factors of the internal environment. More often, researchers focus

on attempts to use internal factors of strengths to reduce external threats. This opinion is shared by the authors of Freeman Publications (2021).

It is proposed to create a new structure – the Artsakh Investment Risk Management Society to organise constant monitoring of the situation in the investment field, improve the quality of education of risk managers, the relationship between education and government, organise consulting, conduct business trainings, seminars, conferences, forums, enhance the image of the NKR as an investment-attractive partner in the international market (Mohajeri Borje Ghaleh *et al.* 2021; Korytarova and Hromadka, 2021). Such independent structures, through direct interaction with the Government, namely with the Ministry of Economy and the Ministry of Urban Development, will be able to implement work on the introduction of new methods for assessing and improving investment risks in practice and apply them to real investment projects. These measures can be another element of the system to increase investment attractiveness and ensure the reduction of financial losses from the implementation of projects and programmes.

Summarising, the main goal of improving investment risk management is: clear identification of factors influencing projects; state support and degree of involvement; increasing the level of investment attractiveness of the NKR; provision of qualified management personnel (risk managers); development of own production (for example, building materials); organisation and support of new organisational structures – Artsakh Risk Management Society; introduction of methodological tools for risk management into the practice of investment project management.

A systematic approach to risk management in the process of attracting investment funds and implementing projects will allow investors and the government to successfully interact, avoiding financial losses and achieving the expected results.

CONCLUSION

Risk assessment occupies an important place in the development of the economy, risk is inherently an integral element of investment and entrepreneurial activity. The degree of risk increases with the level of uncertainty of the state of market relations in

the country (transition period, military operations, disasters, pandemics). In the study, some aspects of investment management in the NKR were considered and clarified, considering the factors of influence of the external and internal environment that form the level of uncertainty, affecting the increased level of investment risk.

In the course of the study, the following tasks were implemented: considering the opinions of different authors and the specific features of the economic development of the Republic of Artsakh, the terminology of risk, political risk, and country risk was clarified. The characteristics of the development of investment activity in the Republic of Artsakh over the past 8-10 years were considered. It is proposed to improve the management of investment activities and reduce risks through the implementation of a systematic approach. The possibility of creating a new management body is being developed – the Artsakh Risk Management Society, which will combine the functions of analysing, planning, monitoring, and implementing investment projects and programmes, while being in direct contact with government agencies to avoid corruption.

It was clarified that political risk reflects all types of administrative restrictions affecting investment and entrepreneurial activity associated with changes in the political area of the state in general. One of the subtypes of which is the influence of military operations. This is typical for a country that has suffered from military invasion repeatedly and continues to actively recover. At the current moment of economic development, investment funds are particularly needed in the construction sector for the restoration of both residential premises and social and infrastructure facilities. Considering the specific features of the development of the Republic of Artsakh, the indicator country risk was clarified – this is a multifactorial indicator, which, in terms of economic content, reflects the solvency of the country from the standpoint of the investor-state.

In the course of the study of theoretical and analytical materials, it was identified that the Republic of Artsakh is at the stage of economic recovery, and investment activity is stimulated almost only in the construction industry. Attracting foreign investment is at a fairly low level and the state support is high but there is no systematic

approach to issues and therefore the risks are very high. After a number of military conflicts and the wave of the COVID-19 pandemic, the situation in the NKR has worsened even more. It is necessary to improve the process of investment risk management to attract investors and ensure the attractiveness of investment and entrepreneurial activities.

The implementation of the developed systematic approach will give confidence to potential investors in obtaining future income and ensure the inflow of investments not only in the construction sector but also in the economy of the Republic of Artsakh in general.

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