X-raying Foreign Direct Investment and Innovation Capability of SMEs in Lagos State

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Abstract
In the 21st century, socio-economic development has largely depends on the success of small and medium enterprises (SMEs). However, the sector has not been able to fully take advantage of FDI to enhance innovation capability of the ventures particularly in developing countries like Nigeria. The study, therefore, leverages dynamic capability theory to x-raying the influence of foreign direct investment on innovation capability of SMEs in Lagos State. A cross-sectional and random sampling techniques were employed to gather data from 382 SME owners/operators in Lagos State from the population of 8,395 out of which 365 were validly filled and returned via snowballing approach representing 95.6% response rate. The primary data were further subjected to statistical analysis using frequency, Pearson Product Moment correlation coefficient, and regression. The study found out that foreign direct investment has significant and positive effects on innovation capability of SMEs in Lagos State in the areas of idea management, service quality delivery, and competiveness. However, the findings of this study demonstrated that FDI has more effect on idea management than service quality delivery and competiveness. The study further proposes that the CEOs or managers in the space of SMEs should engage policymakers to ensure improved infrastructure and resources are in place to support FDI-SMEs intervention arrangement for the purpose of enhancing innovative ideas of the players towards global competiveness.

Keywords: Competiveness of SMEs, FDI, idea management, innovation capability of SMEs, service quality delivery

1.0 Introduction

Evidence in literature has demonstrated that small and medium-scaled enterprises (SMEs) are essentially important in every economy because of the volume of employment opportunities they generate and contributions to national gross domestic product (GDP). The sector also has substantial contributions to local economies by strengthening supply chains and enhancing tax revenue. Recent reports (October, 2024) from BudgIT, a civic tech revealed that only Lagos and Rivers states have an internal generated revenue (IGR) that can conveniently take care of their operating costs. In addition, the IGR of Lagos State is far above every other state in Nigeria. The report of Small and Medium Enterprises Development Agency of Nigeria SMEDAN in 2019 also showed only the state has 11.5% of the total SMEs out of 36 states in Nigeria. The implications of this statistics is that SMEs play significant roles in the IGR of Lagos State. Therefore, there is need to examine external factors that can effectively drive the innovation of this sector in Lagos State for global competiveness.

Innovation capability is regarded as firm's ability to create, and sustain innovative ideas, processes towards addressing changing market needs, and delivering exceptional values to end users (Mendoza-Silva, 2021; Saunila, 2020). It harmonizes resources, and a culture that engenders creative problem-solving (Tidd & Bessant, 2020; Schoemaker, Heaton & Teece, 2018). Through building innovation capabilities of SMEs, they can develop unique products and deliver excellent services that could give them an edge in competitive markets. This adaptability may not just support the survival of SMEs in uncertain situations but could also help them seize new opportunities, and drive long-term resilience and growth. However, SMEs do not have ample resources compared to larger corporations, therefore, the need for external complementary capacities like FDI interventions. Substantial foreign investments in Nigeria's fintech sector have significantly impacted startups like Interswitch and Flutterwave. These companies have received considerable funding from international investors, achieving unicorn status and contributing notably to the digital economy (Damilola, 2022; Ediagbonya & Tioluwani, 2023).

Foreign direct investment involves investing in a business that is in another country (Cole, Elliott & Zhang, 2017). Transcend transferring capital, FDI often introduces valuable resources such as technology, managerial skills, and enhanced production methods, which can drive innovation (Fernandez & Joseph, 2020; Paul & Feliciano-Cestero, 2021). It plays key roles in economic development by fostering employment, improving infrastructure, and potentially enhancing the growth of local industries (Cole, Elliott & Zhang, 2017; Fernandez & Joseph, 2020). Nigeria's fintech industry raised $160.3 million in 2020, accounting for nearly a quarter of all startup through FDI in the country that year (KPMG, 2022). This influx of foreign capital may not only help bridge financial gaps for SMEs but could also drive innovation and integration into global markets.

Discussing FDI intervention and innovation capabilities of SMEs, particularly in developing economies has gained attraction in literature because of lack of access to funding. Given Nigeria's status as a developing economy, FDI could serve as a supplement to domestic investment in driving business success. However, it appears SMEs in Lagos State face challenges in building their innovation capacity, limiting their competitiveness in domestic and international markets. Innovation, which is essentially important for SMEs to develop new products, processes, and services, is often stalled by limited access to modern technologies, skilled labor, and research and development resources.

Insufficient FDI may cause SMEs to face limited access to capital, restricting their capacity to expand, innovate, and generate employment. Lack of funding and expertise for SMEs could lead to decreased productivity and competitiveness, worsening unemployment and underemployment not in Lagos but across the country. Previous studies like Uwubanmwen and Ogiemudia (2016); Demena and van Bergeijk (2017) have empirically examined the interactions between FDI and SMEs in developing countries, but it seems adequate research has been carried out to understand the influence of FDI on innovation capabilities of SMEs in Nigeria and Lagos State in particular. This study, therefore, aims to explore: i) effect of FDI on idea management; ii) effect of FDI on service delivery; and iii) effect of FDI on competiveness of SMEs.

2.0 Literature Review

Conceptual Review

Foreign Direct Investment (FDI)

Foreign direct investment refers to a cross-border investment made by a resident of one economy into an enterprise in another economy, with the aim of establishing a lasting interest in the investee economy (Aevoae, Dicu & Mardiros, 2018; Sudha, 2013). Open economies often attract FDI owing to availability of skilled workforce and the greater-than-expected development opportunities it tends to offer (Nwagu et al., 2023). FDI may include management or technology provisions alongside capital (Orji et al., 2021). The International Monetary Fund (IMF, 1993) and the Organisation for Economic Co-operation and Development (OECD, 1996) state that FDI involves a resident entity from one economy (the direct investor) investing in an enterprise in another economy (the direct enterprise). Over the past two decades, a growing number of developing nations have been attracting substantial and increasing amounts of foreign direct investment (Nwagu et al., 2023; Ogbuabor et al., 2020).

Foreign direct investment is categorized as either inward-FDI or outward-FDI (Fetscherin, Voss & Gugler, 2010; Tembe & Xu, 2012). Inward-FDI refers to investments received by host countries from foreign companies, such as investments in Nigeria by various foreign firms. Outward-FDI, on the other hand, it refers to investments made by domestic firms in foreign markets, such as Globacom's investments in Ghana and Benin. The difference between inflow and outflow of FDI is termed net FDI inflow, and the cumulative number of FDI over a period is referred to as FDI stock.

Innovation Capabilities of SMEs

The two conceptualizations of innovation capability, viewing innovation as a process and as an outcome, are well established in the context of small businesses (Saunila, 2020). Innovation capability is commonly conceptualized as the potential to generate innovative outputs (Dadfar et al., 2013; Keskin, 2006). Some other studies have concentrated on specific sets of innovation capabilities, such as product and process innovation (Oura, Zilber & Lopes, 2016), and management and marketing innovation (Gunday et al., 2011). Other studies have employed a more comprehensive set of innovation capabilities, encompassing product, process, management, and marketing innovation capabilities (Avermaete et al., 2003). In conceptualizing innovation capability in the context of SMEs, research has emphasized innovation both as an outcome and as a process (Ukabuduzhiimkpa & Onuoha, 2023). .

The innovation capacity of small and medium-sized enterprises plays a crucial role in driving economic growth and competitiveness (Ahn, Yoon & Kim, 2018; Gherghina et al., 2020). Their close interactions with customers and swift adaptability to market changes foster a conducive environment for innovation (Saunila, 2020). However, innovation potential of SMEs can be hindered by challenges such as limited access to financing, skilled labor, and advanced technologies (Baporikar, Nambira & Gomxos, 2016; Talegeta, 2014). Addressing these barriers through supportive policies and collaborations could significantly enhance the innovation capacity of SMEs, ultimately contributing to broader economic development and technological advancement.

Idea Management

Idea management is an organized approach for collecting, evaluating, refining, and applying ideas within a firm to stimulate innovation and growth (Gerlach & Brem, 2017). It tends

to encourage contributions from workforce, stakeholders, and customers to enhance products, services, processes, or business models (Mikelsone & Liela, 2017). Effective idea management cultivates a culture of creativity and inclusivity, enabling organizations to adapt to market shifts, address challenges, and sustain a competitive advantage through continuous development and improvement (Joel & Oguanobi, 2024; Mikelsone & Liela, 2017). FDI often brings new technologies, practices, and global market insights that can be harnessed to elevate the innovative capacity of local SMEs (Cuadros, Navas & Paniagua, 2022; Darkwah, Coffie & Antwi, 2021;Park & Roh, 2019). This approach could support SMEs to leverage FDI for greater creativity, improved products or services, and enhanced competitive positioning in both domestic and global markets.

Service Delivery

Service delivery is the process through which an enterprise provides goods/services to its customers or stakeholders (Gradus, Schoute & Budding, 2021; Hinson, Mensah & Odame, 2024). This includes the planning, execution, and management of all necessary components to meet customer needs and ensure satisfaction (Rane, NAchari & Choudhary, 2023). A healthy service delivery system is vital for building trust, fulfilling expectations, and achieving firm's objectives (Wilson, Zeithaml, Bitner & Gremler, 2020). FDI is capable of introducing advanced resources, technologies, and best practices that can improve both the quality and efficiency of service delivery among home-grown SMEs (Gradus, Schoute & Budding, 2021; Prime, 2012).). In addition, efficient service delivery is a foundation of innovation which could allow an SME to speedily adapt and respond to changing market needs (Darkwah, Coffie & Antwi, 2021; McDermott & Prajogo, 2012). On this premise, FDI could engender service delivery for sustainable growth, strengthening the reputation, and enhancing the market position of SMEs.

Competiveness of SMEs

Business competitiveness refers to an enterprise capacity to effectively operate within its industry or market setting (Yuleva, 2019). It encompasses diverse factors crucial for sustaining or advancing market position, profitability, and longevity (Adashev, & Ismoilov, 2021). Essential components of business competitiveness encompass pioneering developments in products, services, and operations, which enable firms to distinguish themselves and adeptly meet evolving consumer demands (Mongerwa, 2024; Yuleva, 2019). The competitiveness of small and medium-sized enterprises is crucial for their success in increasingly globalized and dynamic markets (Ahmedova, 2015). However, SMEs face challenges such as limited access to capital, technology, and skilled labor, which can hinder their competitiveness (Abdullahi, Jakada & Kabir, 2016; Ahmedova, 2015). To overcome these barriers, SMEs could utilize government support in facilitating FDI, engage in strategic partnerships, and invest in technology and talent development.

Theoretical Review

Dynamic Capability Theory

In the opinion of Colombelli, Krafft and Quatraro (2014), and Batista et al (2017), the dynamic capability theory emerged in the 1990s through a series of articles by David Teece and co-authors (1990, 1997) as well as Teece and Pisano (1994). Since its inception, the theory has garnered significant scholarly attention, being considered a potentially comprehensive paradigm for the field of strategic management (Leemann & Kanbach, 2022). Dynamic capabilities are

complex systems of actions and resources that are directed at renewing, updating, modifying, or replacing the existing rent-yielding resources and capabilities of the firm, typically in response to a changing environment (Dooley, Kenny & O'Sullivan, 2017; Mikalef et al., 2018).

Dynamic capability theory asserts that a firm's capacity to adjust, integrate, and reorganize its internal and external competencies is essential for attaining sustained competitive advantage and superior performance in dynamic business environments (Makkonen et al., 2014; Wójcik, 2015). It encompasses the ability to sense market and technological changes, seize opportunities, and continuously refresh and reconfigure the firm's resources and capabilities in response (Furnival, Boaden & Walshe, 2019; Konlechner, Müller & Güttel, 2018). Capabilities are the valuable assets of an organization (Peteraf, Di Stefano, & Verona, 2013; Tartaglione & Formisano, 2018). It is also the result of a learning and selection process which relates to resources of gradual development. One of the critiques of the dynamic capability theory is that it is difficult to measure empirically (Easterby-Smith, Lyles & Peteraf, 2009). However, the theory is relevant to this study because SMEs might need the intervention of FDI for them to be dynamically resilient and innovatively competitive in the national and global markets.

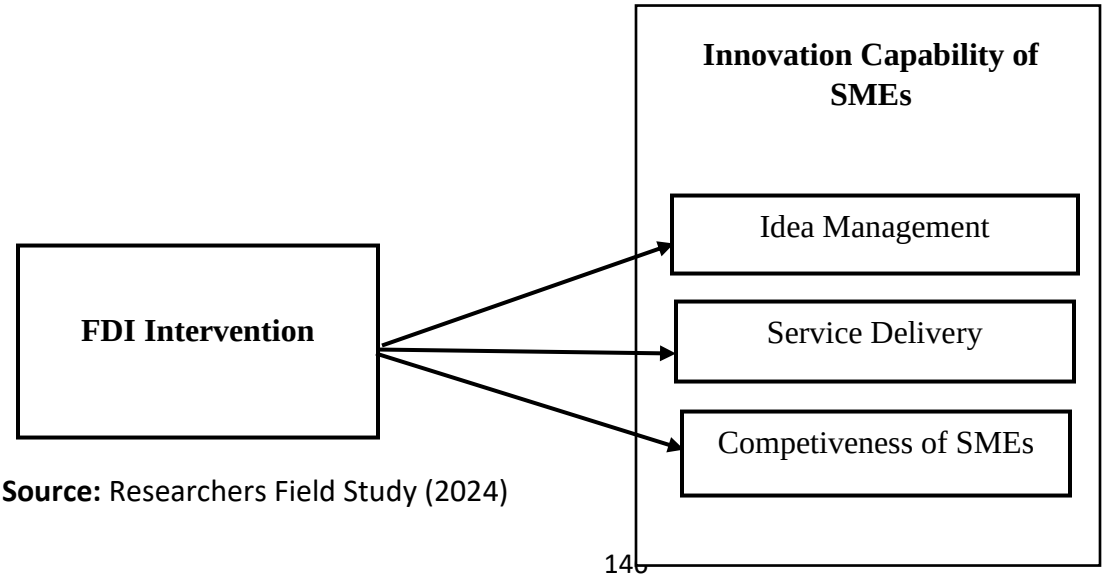
Empirical Review

Shamsub (2023) investigate the influence of FDI on innovation in the developing countries in the direction of idea management with governance playing a mediating role using a quantitative approach through time-series data from 1995 - 2019 from the World Bank Development. The findings also support previous studies which affirm relationship between FDI and innovative idea management.

Attah et al (2023) examine the role of FDI on service delivery performance of service sector in Nigeria from 1980 - 2020 using the data from the Central Bank of Nigeria-CBN Statistical Bulletin 2020. The findings of the study indicate positive interactions between the variables.

Mondal and Pant (2014) explored FDI and firm's competitiveness among manufacturing ventures in India using systematic review. The study further measured competitiveness using network, technology, and organizational skills. The outcomes of the study demonstrated that firm's competitiveness is more achieved with the adoption of FDI rather than by mere purchase of foreign technology.

Conceptual Model



Source: Researchers Field Study (2024)

3.0 Methodology

A survey method is applied in this study because it provides more proficient and representative approach of gathering a large data from SMEs in Lagos State regarding the idea of this study. Small and Medium Enterprises Development Agency of Nigeria –SMEDAN (2019) in conjunction with the National Bureau of Statistics being the most recent published document by the agency, reported that Lagos State has 8,395 out of 73,081 SMEs, and the highest among other states in Nigeria. Accordingly, the population of this study involves 8,395 SMEs in Lagos State as the commercial hub of the country. For choosing a sample size, a formula developed by Yamane (1967) was employed in the study to arrive at sizable number of approximately 382 from the population of 8,395 SMEs in Lagos State. A cross-sectional and random sampling techniques were adopted to gather data from 382 SME Owners/Operators in Lagos State out of which 365 were validly filled and returned using snowballing approach representing 95.6% response rate. The retrieved primary data were further subjected to statistical analysis with the aid of frequency, Pearson Product Moment correlation coefficient, and regression, and they are all statistically significant.

Analysis

Testing of Hypotheses

Table 1: Correlation matrix among the study variables

	Variable	N	Mean	Std. Dev.	Sig.	1	2	3	4
1	IDM	365	4.07	.532	.000	1			
2	SED	365	3.90	.538	.000	.766**	1		
3	COS	365	3.81	.678	.000	.247**	.404**	1	
4	FDI	365	4.09	.546	.000	.638**	.261**	.213*	1

Keys: *IDM = Idea Management; SED = Service Delivery; COS = competiveness of SMEs; FDI = Foreign Direct Investment; N= Total number of the participants; Std. Dev. = Standard Deviation*

Source: Field computation of the researchers (2024)

Preliminary checks were carried out in table 2 to understand the statistical outcomes of inferential statistics that was further considered in this study using mean, standard deviation, and Pearson Product Moment correlation coefficient. To examine mean is important in this study because it represents the central point of a dataset, offering an average value that can capture the overall results. The study went further to check for standard deviation of the data to measure the extent to which the data used in this study likely digress from the mean. A minimal standard deviation (i.e. close to zero) suggests that data points are tightly clustered around the mean, while a greater standard deviation signifies that the data points are more isolated from the mean. Therefore, table 1 indicated a mean between 3.81 and 4.09 which is suitable for a central point within a 5 likert scale as deployed in this study. The standard deviation between 0.532 and 0.678 has demonstrated good confidence and prescription.

Also, the correlation matrix in table 1 illustrates the relationships among the study's variables and is deployed to examine the correlation coefficients. However, the findings do not indicate prediction, but to demonstrate the interactions among the variables with the use of Pearson correlation statistical analysis at $**p< 0.01$. In table 1, Foreign Direct Investment (independent variable) is significantly correlated to the three components of innovation capability of SMEs in Lagos State as examined in this study (idea management = 638^{**}, $p< 0.01$,

service delivery = .261** p< 0.01, and competiveness of SMEs = .213**, p< 0.01). In addition, the association among the 3 dependent variables (idea management, service delivery, and competiveness of SMEs) was positive and significant (between .247** p< 0.01, and .766** p< 0.01). Taking Consideration of the level of association between independent and dependent variables, and among dependent variables, the study presumed that they are reasonably normal as they floated between -0.01 and .766 which does not create any concerns for multicollinearity.

Table 2: Presents regression analysis for independent and dependent variables

Model		Unstandardized Coefficients		Standardized Coefficients			
		B	**Std. Error**	**B**	**T**	**Sig.**	**Remarks**
1	(Constant)	1.1529	.162		8.408	.000	Significant
	IDM	.622	.039	.638	15.785	.000	Significant
2	(Constant)	2.848	.206		13.819	.000	Significant
	SED	.257	.050	.261	5.154	.000	Significant
3	(Constant)	2.729	.263		10.381	.000	Significant
	COS	.264	.064	.213	4.144	.000	Significant

Source: Field computation of the researchers (2024)

DVs: *Idea Management - IDM*, *Service Delivery-SED*, & *Competiveness of SMEs - COS* (*P*<0.05)

IV: *Foreign Direct Investment (FDI)*

The regression analysis in table 2 tests the objectives of this study whereby R coefficient shows the association between independent variable and each dependent variable. Accordingly, the R coefficients of 0.638 for FDI and idea management; 0.213 for FDI and service delivery; and 0.206 for FDI and competiveness of SMEs indicate positive relationship in all objectives.

The F-statistic value of 249.181, *P* <0.05 for objective one; 26.565, *P* <0.05 for objective two; and 17.172, *P* <0.05 for objective three indicated the goodness of fit of the models to explain the variants in all objectives. . In addition, the Beta (β) values of .622 for objective one; .257 for

objective 2; and .264 for objective three confirmed positive association between the variables across all the objectives. The value of t=15.785, p<.05 for objective one; t=5.154, p<.05 for objective two; and t=4.144, p<.05 for objective three showed that predictor's variable (FDI) has significant effect on each dependent variable (IDM, SED & COS). However, individually, the results demonstrated that FDI has more significant effect and contribution on idea management (.15.785), followed by service delivery (5.154), and competiveness of SMEs (4.144).

4.0 Discussion of Findings and Conclusion

Globalization has made business environment a global village whereby resources can easily be exchanged between firms or individuals in different countries. Consequently, this study indicate that an SME that receives FDI gain exposure to advanced technologies, global best practice, and new business models which eventually promote innovation and drive the development of new products, services, and processes. It is established in the findings of this study that FDI intervention aids SMEs idea management, particularly through partnerships with foreign firms that grant access to advanced knowledge and expertise. This turns out to stimulate innovation capability of SMEs, and better meet market demands, achieve global competitiveness, and improve growth potential. This aligns with the study of Shamsub (2023) who submit that there is strong relationship between FDI and innovative idea management.

The outcomes of this study demonstrate that FDI serves as a key driver in developing essential resources that encourage creativity, adaptability, and competitive strength towards service quality delivery of SMEs. FDI has a transformative influence in helping SMEs to produce new products, services, and processes that align with market needs, thereby augmenting their standing in local and global markets. This finding corroborates Attah et al (2023) with the submission that FDI has significant influence on service delivery in the Nigerian service sector. In addition, the outcome of this study revealed that FDI has significant effect on competiveness of SMEs, and this is in tandem with Mondal and Pant (2014). On this preemie, this study concludes that FDI has significant and positive effects **on** innovation capability of SMEs in Lagos State.

5.0 Implications for Practice

This study investigated the influence of FDI on innovation capabilities of SMEs with a focus on enterprises in Lagos State. For SMEs to fully enhance idea management, there is need for CEOs or managers operating the ventures to prioritize building strategic partnerships with foreign investors, centering on knowledge exchange and collaborative research and development efforts that support the transfer of advanced technologies and innovation practices. Additionally, investing in employee training programs that build skills in handling new technologies and processes is essential, ensuring that foreign expertise is successfully absorbed and integrated to enhance the SME's innovation capability. The players in the SMEs should also engage policymakers to ensure improved infrastructure and resources are in place to support FDI-SMEs intervention arrangement. By participating in both local and global industry networks, operators of local ventures can stay informed of global innovation trends and connect with potential investors and experts.

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