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THE NECESSITY AND THEORETICAL FOUNDATIONS OF ATTRACTING FOREIGN INVESTMENT TO SMALL BUSINESSES

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Abstract. Small businesses play a crucial role in ensuring economic growth, increasing employment, fostering innovation, and enhancing the competitiveness of national economies. In the context of globalization and increasing international economic integration, attracting foreign investment has become one of the key factors supporting the sustainable development of small business entities. This study examines the necessity of attracting foreign investment to small businesses and analyzes its theoretical foundations. The research explores the economic significance of foreign direct investment (FDI), its impact on productivity, technological advancement, managerial efficiency, and market expansion within the small business sector. Furthermore, the article reviews the main theoretical approaches explaining investment flows, including modernization theory, endogenous growth theory, and investment climate concepts. The findings indicate that foreign investment contributes to the financial stability of small enterprises, facilitates knowledge transfer, and strengthens their integration into global value chains. The study concludes that creating a favorable investment environment and implementing effective institutional mechanisms are essential prerequisites for increasing foreign investment inflows into small businesses and ensuring their long-term competitiveness.

Keywords: Foreign investment; foreign direct investment (fdi); small business; economic development; investment climate; entrepreneurship; innovation; competitiveness; sustainable growth; global value chains; financial resources; investment attractiveness.

Introduction

Small businesses are widely recognized as one of the most important drivers of economic growth, employment generation, innovation, and social welfare in both developed and developing countries. Their flexibility, adaptability to market changes, and ability to create new jobs make them an essential component of a competitive and sustainable economy. In recent decades, the increasing integration of national economies into the global economic system has created new opportunities and challenges for small businesses. In this context, attracting foreign investment has become a significant factor in strengthening the financial and technological capacity of small enterprises and enhancing their contribution to economic development.

Foreign investment, particularly Foreign Direct Investment (FDI), serves as a vital source of capital, advanced technologies, managerial expertise, and international business practices. Unlike domestic financial resources, foreign investment often provides access to global markets, modern production techniques, and innovative management systems. These advantages are particularly important for small businesses, which frequently face constraints related to limited financial resources, inadequate technological capabilities, and restricted access to international markets. Consequently, foreign investment can play a transformative role in improving productivity, competitiveness, and long-term sustainability within the small business sector.

The importance of attracting foreign investment to small businesses has increased significantly in the era of globalization. As international trade and investment flows continue to expand, countries are increasingly competing to attract foreign capital by improving their investment climate, regulatory frameworks, and institutional quality. For developing economies, foreign investment not only contributes to economic growth but also facilitates structural transformation, technological modernization, and the development of entrepreneurial ecosystems. Small businesses benefit from these processes through increased access to capital, knowledge transfer, and integration into global value chains.

From a theoretical perspective, the relationship between foreign investment and small business development can be explained through several economic theories. Modernization theory emphasizes the role of external capital and technology in accelerating economic progress. Endogenous growth theory highlights the importance of knowledge spillovers, innovation, and human capital development generated by foreign investment. Additionally, theories of investment attractiveness and institutional economics suggest that a favorable business environment, political stability, and effective governance are critical factors influencing foreign investors' decisions. These theoretical approaches provide a comprehensive framework for understanding the mechanisms through which foreign investment contributes to the growth and development of small businesses.

Despite the substantial benefits associated with foreign investment, many small enterprises continue to encounter challenges in attracting international capital. These challenges include insufficient access to financial information, weak institutional support, regulatory barriers, and limited investment promotion mechanisms. Therefore, studying the necessity and theoretical foundations of attracting foreign investment to small businesses is of considerable academic and practical importance. Understanding these aspects can help policymakers design effective strategies to improve investment attractiveness and enhance the role of small businesses in national economic development.

The purpose of this study is to examine the necessity of attracting foreign investment to small businesses and to analyze the main theoretical approaches that explain its significance. The research aims to identify the economic benefits of foreign investment, explore the theoretical foundations of investment attraction, and provide recommendations for strengthening the investment potential of small business entities in the modern economy.

Literature review

The issue of attracting foreign investment and its impact on small business development has received considerable attention in economic literature. Researchers have extensively examined the relationship between foreign direct investment (FDI), entrepreneurship development, productivity growth, and economic competitiveness. Existing studies suggest that foreign investment contributes not only to capital accumulation but also to technological advancement, managerial improvement, and the expansion of market opportunities for small and medium-sized enterprises (SMEs).

One of the foundational theoretical contributions to foreign investment research was made by Dunning (1988) through the Eclectic Paradigm (OLI Framework), which explains international investment decisions based on ownership, location, and internalization advantages. According to this theory, foreign investors are more likely to invest in countries that offer favorable business environments, stable institutions, and attractive market conditions. The

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framework remains one of the most widely used approaches for analyzing FDI inflows and their effects on local enterprises.

The endogenous growth theory developed by Romer (1990) highlights the importance of knowledge transfer, innovation, and human capital in achieving sustainable economic growth. This theory suggests that foreign investment serves as a channel for technological spillovers and learning opportunities, enabling domestic firms, particularly small businesses, to improve their productivity and competitiveness. Similarly, Grossman and Helpman (1991) argue that international investment facilitates the diffusion of technology and managerial expertise across economies, thereby enhancing long-term economic performance.

Recent empirical studies have further confirmed the positive relationship between foreign investment and small business development. According to OECD (2023), foreign direct investment significantly contributes to entrepreneurship growth by providing access to financial resources, advanced technologies, and international business networks. Small enterprises that engage with foreign investors often demonstrate higher productivity levels, stronger export performance, and greater innovation capacity than firms relying solely on domestic capital sources.

Research conducted by the World Bank (2024) indicates that foreign investment plays a critical role in supporting small business resilience and growth, particularly in developing countries. The study emphasizes that FDI promotes employment creation, facilitates access to global value chains, and enhances firms' ability to adopt modern production methods. Moreover, countries with favorable investment climates tend to attract higher levels of foreign capital, resulting in stronger private sector development and improved economic outcomes.

Another important strand of literature focuses on institutional factors affecting foreign investment attraction. North (1990) argues that institutions, legal systems, and governance structures significantly influence economic performance and investment decisions. In this context, transparent regulations, property rights protection, and political stability are considered essential prerequisites for attracting foreign investors. Contemporary studies by the United Nations Conference on Trade and Development (UNCTAD, 2024) support this view, emphasizing that institutional quality remains one of the key determinants of international investment flows.

Several scholars have also investigated the specific challenges faced by small businesses in attracting foreign investment. Beck and Demirgüç-Kunt (2006) note that limited access to finance, insufficient managerial capacity, and information asymmetries often hinder small enterprises from benefiting fully from international capital flows. More recent studies indicate that digital transformation, innovation policies, and investment promotion programs can help overcome these barriers and increase the attractiveness of small businesses to foreign investors.

Methodology

This study employs a qualitative research approach to examine the necessity and theoretical foundations of attracting foreign investment to small businesses. The research is based on a comprehensive review and analysis of existing academic literature, international reports, and theoretical frameworks related to foreign direct investment (FDI) and small business development.

The study utilizes comparative, analytical, and descriptive research methods. The comparative method is applied to evaluate different theoretical approaches explaining the relationship between foreign investment and small business growth. The analytical method is used to identify the economic mechanisms through which foreign investment influences productivity, innovation, competitiveness, and financial sustainability in small enterprises. The descriptive method enables the systematic presentation of theoretical concepts and empirical findings obtained from previous studies.

Secondary data constitute the primary source of information for this research. The study draws upon publications from international organizations such as the Organisation for Economic Co-operation and Development (OECD), World Bank, and United Nations Conference on Trade and Development, as well as articles published in peer-reviewed academic journals. These sources provide reliable information regarding investment trends, small business performance, and the role of foreign capital in economic development.

To achieve the research objectives, the study applies a theoretical synthesis approach by integrating concepts from the Eclectic Paradigm (OLI Theory), Endogenous Growth Theory, Modernization Theory, and Institutional Economics. This approach allows for a comprehensive understanding of the factors influencing foreign investment attraction and its contribution to small business development.

The methodological framework of the research consists of four stages: (1) identification and collection of relevant scientific literature and institutional reports; (2) classification and analysis of theoretical approaches related to foreign investment and entrepreneurship; (3) evaluation of empirical evidence regarding the impact of foreign investment on small businesses; and (4) formulation of conclusions and policy recommendations based on the findings.

The chosen methodology provides a systematic basis for examining the necessity of attracting foreign investment to small businesses and for assessing its theoretical significance in promoting sustainable economic growth, innovation, and competitiveness.

Analysis and results

The analysis demonstrates that attracting foreign investment to small businesses is a critical factor in enhancing their financial capacity, technological capabilities, and overall competitiveness. In the modern global economy, small enterprises frequently encounter challenges related to limited access to capital, insufficient technological resources, and restricted participation in international markets. Foreign investment helps overcome these constraints by providing not only financial resources but also access to advanced technologies, managerial expertise, and international business networks.

The theoretical analysis indicates that the positive impact of foreign investment on small business development can be explained through several economic frameworks. According to the Eclectic Paradigm (OLI Theory), foreign investors are more likely to invest in economies where favorable location-specific advantages exist, including market potential, institutional stability, and investment-friendly regulations. Small businesses operating within such environments gain opportunities to cooperate with foreign partners, improve operational efficiency, and expand their market reach.

The findings further reveal that foreign investment contributes significantly to productivity growth among small enterprises. Through technology transfer and knowledge spillovers, foreign-invested businesses often introduce innovative production methods, digital technologies, and modern management practices. These innovations increase labor productivity, reduce operational costs, and improve product quality. As a result, small businesses become more competitive in both domestic and international markets.

Another important finding concerns the role of foreign investment in fostering innovation. Foreign investors frequently bring research and development practices, technical expertise, and international standards that stimulate innovation activities within local enterprises. Small businesses exposed to foreign investment tend to adopt new business models, improve product development processes, and invest more actively in technological modernization. Consequently, innovation becomes a key driver of sustainable growth and long-term competitiveness.

The analysis also highlights the employment effects of foreign investment. Increased capital inflows into small businesses support business expansion and create new job opportunities. In addition to generating employment, foreign investment contributes to the development of human capital through employee training, skill enhancement, and the dissemination of modern business knowledge. These benefits strengthen the overall productivity of the workforce and support broader economic development objectives.

Table 1 summarizes the major benefits of foreign investment for small businesses.

Table 1.

Main effects of foreign investment on small business development

Area of Impact	Key Benefits
Financial Resources	Increased access to capital and investment financing
Technology Transfer	Adoption of advanced technologies and production methods
Innovation	Enhanced research, development, and product innovation
Employment	Creation of new jobs and workforce development
Competitiveness	Improved efficiency and market performance
Internationalization	Access to global markets and value chains
Management Quality	Introduction of modern management practices

The results also indicate that the effectiveness of foreign investment largely depends on the quality of the investment environment. Countries characterized by transparent regulations, political stability, strong legal institutions, and investor protection mechanisms generally attract higher levels of foreign capital. For small businesses, supportive government policies, tax incentives, simplified administrative procedures, and effective investment promotion programs increase opportunities to establish partnerships with foreign investors.

However, the analysis identifies several barriers that limit foreign investment attraction to small businesses. These include insufficient access to information, weak financial reporting systems, inadequate infrastructure, limited innovation capacity, and regulatory complexities. Such challenges reduce investor confidence and restrict the ability of small enterprises to benefit fully from international capital flows. Therefore, improving institutional quality and strengthening entrepreneurial capabilities remain essential priorities for policymakers.

The findings confirm that foreign investment serves as a powerful instrument for accelerating small business development. By enhancing access to finance, technology, knowledge, and international markets, foreign investment supports sustainable economic growth and strengthens the competitive position of small enterprises. The analysis further suggests that a favorable investment climate and effective institutional mechanisms are fundamental conditions for maximizing the benefits of foreign investment and ensuring the long-term success of small businesses.

Conclusion and recommendations

The study examined the necessity and theoretical foundations of attracting foreign investment to small businesses and identified its significant role in promoting economic growth, innovation, competitiveness, and sustainable development. The findings confirm that foreign investment is not only a source of financial capital but also an important channel for technology transfer, managerial knowledge, innovation diffusion, and integration into global markets. These factors contribute substantially to strengthening the operational efficiency and long-term sustainability of small enterprises.

The theoretical analysis demonstrated that foreign investment positively influences small business development through various mechanisms explained by the Eclectic Paradigm (OLI Theory), Endogenous Growth Theory, Modernization Theory, and Institutional Economics. These theories collectively suggest that foreign capital enhances productivity, stimulates innovation, improves human capital, and supports economic modernization. Moreover, the effectiveness of foreign investment largely depends on the quality of the investment climate, institutional framework, and the capacity of small businesses to absorb and utilize external resources efficiently.

The results further indicate that small businesses benefiting from foreign investment generally achieve higher levels of productivity, competitiveness, and market expansion. At the same time, several obstacles continue to limit foreign investment inflows, including administrative barriers, insufficient access to financial information, weak institutional support, inadequate infrastructure, and limited innovation capabilities. Addressing these challenges is essential for maximizing the developmental impact of foreign investment.

Based on the findings of the study, the following recommendations are proposed:

1. **Improve the investment climate** by ensuring regulatory transparency, strengthening legal protection for investors, and simplifying business registration and licensing procedures.
2. **Enhance institutional support mechanisms** for small businesses through specialized investment promotion agencies, advisory services, and investment facilitation programs.
3. **Expand financial infrastructure** to improve small enterprises' access to credit, venture capital, and alternative financing instruments that can complement foreign investment.
4. **Promote innovation and digital transformation** by encouraging technology adoption, research and development activities, and collaboration between small businesses and foreign investors.
5. **Strengthen human capital development** through professional training programs, entrepreneurship education, and skill-enhancement initiatives aimed at increasing the absorptive capacity of small enterprises.
6. **Develop international partnerships and business networks** that facilitate cooperation between domestic small businesses and foreign investors, thereby increasing opportunities for knowledge transfer and market integration.
7. **Introduce targeted government incentives** such as tax preferences, investment guarantees, and support programs for foreign-invested small enterprises operating in priority sectors of the economy.

In conclusion, attracting foreign investment to small businesses should be considered a strategic priority for achieving sustainable economic development. A favorable investment environment, effective institutional frameworks, and strong entrepreneurial capacities will enable small businesses to benefit more effectively from foreign capital and contribute significantly to national economic growth, employment generation, and international competitiveness.

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