FINANCING MARKET INNOVATION BY KNOWLEDGE-INTENSIVE BUSINESSES FOR SOCIO ECONOMIC ADVANCEMENT IN EMERGING ECONOMIES

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ABSTRACT

This paper aims to investigate the strategies for financing new market innovation by Knowledge-Intensive Business Services (KIBS) firms for socio-economic advancement in Nigeria. A framework is built in which small firms finance new market innovations through utilizing finance from two distinct institutional sources, which are formal (e.g. banks) and informal (e.g. cooperatives etc.) institutions. Primary data through a survey of 510 small and medium sized enterprises (SMEs) inknowledge-intensive businesssector of Lagos, Nigeria at firm level is employed. The findings suggest that the informal sources accommodate the needs of small firms in a developing economy and serve as the primary source of finance for new market innovation. Thus, the informal system should be acknowledged as an integral part of the institutional system influencing innovation in emerging economies. The scope of the study is restricted to only KIBS SMEs in one local context, Lagos, Nigeria. The findings could assist in formulating policy frameworks for supporting innovation, based on utilization of external financial resources by KIBS SMEs in Nigeria. This paper contributes to the literature on financing market innovation and the institutional theory of entrepreneurship in emerging countries, by providing a better understanding of the strategies of the formal and informal institutional sources of finance that are connected with new market innovation by KIBS SMEs in emerging economies.

Keywords: Innovation, Finance, Knowledge-Intensive Businesses (KIBS)

1.0 INTRODUCTION

This paper investigates the strategies for financing new market innovation by Knowledge-Intensive Business Services (KIBS)firms for socio-economic advancement in Nigeria.KIBSare entrepreneurial firms "performing, mainly for other firms, services encompassing a high intellectual value-added" (Muller and Zenker,2001p.1502).KIBS operates mainly with qualified professionals who specialize in particular technological fields of study or any functional area to provide information, knowledge or other knowledge-based services to customers or client-firms. KIBS are very important tothe economy in the creation and implementation of new products, services and processes as carriers, shapers, facilitators and creators of both technological and managerial innovations(Kuusisto & Viljamaa, 2004). There is presently a global awakening in the KIBS sectors about the relevance of new market innovation (NMI) in this technological advancement age as one of the most rapidly developing sector of the economy (Baró, 2008). Innovation is critical to its growth, and therefore, it is seeking expansion from one place to another by introducing the service to any existing market or new group of users or creating a new market where none existed for growth and profitability thereby satisfying unfulfilled needs of the community to become a knowledge society. KIBS sector has become very notable in this millennium and they use the Small and Medium sized Enterprises (SMEs) as main actors for NMI because SMEs are often referred to as an 'engine of innovation' (Acs, 2006). Finances are needed for market innovation. Financial resources are very integral to the effective functioning of SMEs and large firms and can be obtained from the institutions. A survey of 510 SMEs in KIBS sector of Lagos, Nigeria at firm level is employed. The findings suggest that the informal sources accommodate the needs of small firms in emerging economies and serve as the primary source of finance for new market innovation. The findings could assist in formulating policy frameworks for supporting innovation, based on utilization of external financial resources by KIBS SMEs in Nigeria. This paper contributes to the literature on financing market innovation and the institutional theory of entrepreneurship in emerging countries, by providing a better understanding of the strategies of the formal and informal institutional sources of finance that are connected with new market innovation by KIBS SMEs in emerging economies.

2.0 RESEARCH OBJECTIVES

The main objective of this paper is to investigate the strategies employed for financing market innovation by KIBS in emerging economies. This objective will be achieved by answering this research question: What sources of finances are available for KIBS market innovation in emerging economies?

3.0 INSTITUTIONAL THEORY

Institutional theory is one of the significant theories that explains or explores organizational activities to a large extent (Barley & Tolbert, 1997; Scott, 1995; Zucker, 1987). Institutions set the rules and norms, constraints and privileges with enforcement features being followed in any society. Most research conducted under the flag of modern institutional theory emphasize issues of change in established organizations (For instance,Greenwood & Suddaby, 2006; Lounsbury, 2001; Tolbert & Zucker, 1983) and was used to explore studies in entrepreneurship discipline (for instance,Ahlstrom & Bruton, 2002; Hoskisson, Eden, Lau, & Wright, 2000; Peng, Wang, & Jiang, 2008) rather than on strategies for financing innovation by KIBS.

North (1990) developed a typology of formal and informal institutions. Formal institutions comprisethe written policies, laws and regulations about an economy while informal institutions are codes of conduct, traditions, and norms of behavior, and conventions that sprang from the society's culture (North, 2003). These are devices which run in tandem with formal institutions as problem-solving instruments.Formal institution's structures the regulations and deregulations, taxes and taxation rules, rate of interest and loan repayments, regulatory codes and bureaucracy and lots more that guide different organizations in implementing their functions. The informal institutions code-of-conduct, sometimes unwritten but known by almost every member of the society since they are oral tradition passed from generation-to-generation and part of the culture (Ekpo and Umoh, 2011).SMEs could approach informal organizations for resources for NMI where they may be unobtainable from the formal organization.Summarily, the rules-of-the-game facilitates social interactions and minimizes uncertainty through structural provisions. Where the formal and informal institution overlaps, the formal becomes difficult to enforce, then the informal takes pre-eminent(Sautet, 2005). KIBS SMEs could employ formal and/or informal sources as strategies for financing their innovation depending on their ability to comply with the rule-of-the-game.

3.0 LITERATURE REVIEW

3.1 New Market Innovation Concept

The exploitation of new ideas for business purpose is referred to as innovation (S. Shane & Venkataraman, 2000). Thus by innovation, reference is being made to (Schumpeter, 1934): 1) the production of new products, 2) introduction of new processes, 3) opening of a new market, 4) identification of new sources of raw material supply and, 5) the introduction of new kinds of industrial organization.

Innovation generally depends on the possibility of a market place where it can be converted to economic rent, whether in an existing market or by creating a new market where none existed (Mitra, 2012; OECD/Eurostat, 2005). This suggests the great importance of new market opening as an innovation (Klepper & Thompson, 2006) because market creation provides opportunities for entrepreneurs to operate (Acs and Virgill, 2009). New market opening according to the OECD/Eurostat (2005) is different from other types of innovation by its main objective to increase the volumes of sales or market share which consequently affects the firm's size and profitability. It is the act of pioneering a new market into other regions (Klepper and Thompson, 2006) aimed at better addressing customers' needs and increasing firms' credibility. It is linked with structural changes in an economy which can produce a positive effect on development (Acs and Virgill, 2009). KIBS SMEs that wants to open new market need finances for their innovation hence this paper considers the strategies for financing NMI in emerging economies.

The nucleus of the dimensions of innovation is the continual creation of novel ideas by innovative firms which steadily destroys the position of dormant firms. However, while numerous studies have examined the determinants of products/service innovations (OECD/Eurostat, 2005), very little effort has been placed on studying the financing of new market innovation (Akoni, 2011), especially in emerging economies. This is particularly important because there are many firms that experienced tremendous growth due to their vision for NMI (Akoni, 2011). Some started small and became multinationals through expansion into new markets by embracing pioneering work. Examples of such firms in Africa are Safaricom in Kenya, whose pioneering work on mobile banking has become so prominent in emerging economies that now even some developed economies are trying to emulate it (Dahunsi, 2012). However, finance is crucial to all forms of innovation.

3.2 Importance of finance to KIBS SME

Financial resources are tangible resources, usually sourced internally and externally but often in monetary form. It is the most liquid and flexible resource of a firm which becomes valuable only when utilized (Wickham, 2006). However, SMEs generally lack this critical resource (Hadjimanolis, 2000) and becomes very challenging for innovative SMEs. In this contemporary knowledge-based economy, KIBS SMEs are firms with high growth potential that are very important in raising productivity and maintaining competitiveness(Wickham, 2006) which enables wealth generation. Innovative firms like KIBS that require finance to flourish and promote great ideas to avoid discontinuity and becoming a potential growth loss for the economy. Oswald (2003) expressed the importance of finance whether equity or debt in every operational stage of a firm even though different sources are more available to different growth stages (Wickham, 2006). However, the convention has been to focus on supply and demand of finance to SMEs separately but in real life they are co-dependent because the condition of supply may affect demand for any finance (Berger & Udell, 1998; Howorth, 2001; Myers, 1984). As a business thrives more financial resources are needed for expansion and implementation of innovation.

Conventionally, in developing economies, finance from the network of family and friends play atremendous role but growing KIBS SMEs obtain internal finances often from personal savings, retained earnings, sales of assets, and other forms (Bartholdy & Mateus, 2009) which are inadequate as they grow. External finance are required for innovative activities like NMI but they are hesitant in using a particular source of finance because of the supply restrictions thus the pecking order operates (Howorth, 2001). The pecking order hierarchy of finances is that firms use internal finance prior to external finance and when external financing is necessary, debts are preferred to equity (Beck & Demirguc-Kunt, 2006; Paul, Whittam, & Wyper, 2007; Ross, 1977) and might not exempt KIBS SMEs. KIBS SMEs employ a variety of unconventional strategies and techniques to obtain finances. Research in developing economies identified similar trends that entail series of creative mechanisms to leverage intangible and tangible assets (Lahm Jr & Little Jr, 2005; Neeley, 2003). In embarking on NMI, KIBS SMEs need finance for an array of expenditure which includes recruitment of specialized staff and general staff salary and wages, purchase of assets including business site/premises, office equipment, expansion of operating systems, publicity, advertisement and promotions, R&D, network and collaborations, and other things. Spending on these would assist in resist competitors(Lieberman & Montgomery, 1998) and also maintain a competitive advantage. Nevertheless, finance could be found in the institutional set-ups.

3.3 Formal and informal financial institutions

In consonance with institutional theory, majority of the developing and emerging economies financial system is dualistic in nature comprising: formal and informal with different kinds of operators and little or no contact with each other or their clients (Aryeetey, 2008; Demirguc-Kunt, Klapper, & Panos, 2011). Tsai (2004) argued that entrepreneurs in certain developing economies have variety of techniques and institutions that provides external finance. The formal financial system on one hand comprises of the banking sector, non-banking sector and the financial markets that are registered and regulated by the Federal Ministry of Finance and Central Bank of Nigeria. They are basically commercial banks and security markets. On the other hand, the informal financial system is made up of all transactions, loans and savings that exist outside the regulated monetary legal framework not integrated with the formal financial system. They include organizations such as the local moneylenders, cooperative societies, rotating savings and credit associations (Nigeria, 2005) loans, gifts and remittances from family and friends (Demirguc-Kunt et.al., 2011). Commercial banks offer short-term (overdraft) or long-term loans. They could be unsecured borrowing through credit cards which is common in developed economies while overdraft (S. Shane, 2008) is more often found in developing economies. More generally, SMEs in most developing/ emerging economies become agitated by poor formal institutions and market breakdown thereby patronizing the private governance systems in form of networks and business relationships (Beck and Demirguc-kunt, 2006).Between 87% and 100% of capital raised by entrepreneurs from developing/emerging markets are from informal sources (Bygrave, 2003) However, the informal institutions are weakly developed and restricted in scope but they are often available without much stress.

4.0 METHODOLOGY

The study employed the quantitative research design which is mainly the product of statistical summary and analysis.Lagos was the study area. It has the highest concentration of financial and educational institutions in Nigeria, thereby making it more suitable for addressing the research problem of this study. Lagos is a cluster of businesses, industries and higher education (Uzowanne, 2011). For instance, there is the renowned 'computer village' at Ikeja that is a cluster of all forms of ICT related products, general services and KIBS SMEs (Uzonwanne, 2011). It is a market patronized nationally and internationally (Uzonwanne, 2011). A survey was carried out with a self-administered questionnaire. 10 points likert scale with close-ended questions was used except for the demographic section. Each item has ten responses in which respondents have to indicate: (0) Not Applicable, (1-10) 'Not Important at all' to 'Very Important'. The highest is ten while the lowest is zero points respectively. Data collection was done in 2012. The population frame for the study is all registered KIBS SMEs in Lagos constructed from Nigerian Yellow Pages (2011) and Nigeria Search Engine (2011) which are the commonly used business directories in Nigeria. The population frame consisted of 1742 KIBS SMEs with criteria that 1)The firms must be KIBS SMEs (Miles, Kastrinos, Bilderbeek, & den Hertog, 1995; SIC, 2007) with number of employees less than 250 (European Commission, 2002) to ensure they are not corporate organizations**.** The must be registered and located in Lagos (A. Bryman & Teevan, 2005; Creswell, 2009), and be young firms of 20 years and below (Lindholm, 1999; Rickne & Jacobsson, 1999; Sæmundsson, 2003) to guarantee being KIBS SMEs with reasonably high innovative behaviors(Audretsch, 1998; Novalis Research, 2004).

A random sampling method was adopted because it accords each element in the population an equal and independent chance of being selected as a sample(Kumar, 2005) thus 871 were randomly selected with 510 respondents. This accounted for 57% of the sample. The empirical research was carried out in two ways: a pilot study and the main survey on external financial strategies by KIBS SMEsfor market innovation. There were three questions with 15 items to collect data on strategies for financial resources used for NMI during the period 2006-2011. Attention was particularly placed on information relating to formal and informal sources of finance that enabled NMI. Respondents were to rate the sources in order of importance for innovation. The samples were mainly for SMEs thus making the measures relevant for this study. The reliability measure is Cronbac Alpha .931. The result is based on maximum level of risk that is usually taken in social science research as the $p< 0.5$ level(A. Bryman & Bell, 2011; A. Bryman & Cramer, 2003).

4.0 DISCUSSION

The factor analysis compressed the initial variables into two namely 'formal' and 'informal' sources after extracting eigenvalue more than one. Statistically, it was pertinent to examine the form of association existing between external sources of finance and NMI (Floyd and Widaman, 1995, Bryman and Cramer, 2003). Pearson-Moment correlation was used to establish the logical link in terms of variables considered (Capello, 1999; Manimala, 1999; Rabellotti & Schmitz, 1999).

The correlation coefficient was significant at P<.01 for the two variables. Multiple regression analysis was applied to check the explanatory power of the strategies for external sources of financial resources and the outcome variable, NMI. Thus, the assumptions of heterogeneous behavior of KIBS SMEs are supported. Nevertheless, the institutional context of the formal and informal sources of resources is a point of investigation as the regression is run to ascertain the predictive power of the explanatory variable over the criterion variable, NMI.

Table 1: Factor analysis for the NMI

Factor 1: Newness as Market Innovation	
Newly introduced to the country	0.80
Newly introduced to the firm	0.81
Newly introduced to the market	0.77
New to a group of people as customers /client firm	0.83
Newly introduced to the environment	0.60
Improved version of a previous product/service	0.71
Presented in a different ways from other firms	0.72
Explained variance by the factor: 56.9% ; KMO.83 Chronbac alpha .86	

Extraction Method: Principal Component Analysis

Statistically, the factor is satisfactory as it explained above average outcomes of the total variance. The factor components were tested for reliability using Chronbac alpha with an average score of .86 which can be considered reliable (Bryman and Bell, 2003). However, newness to market innovation was used to extend the measure for NMI by KIBS SMEs.

Table2: Factor analysis for independent variables

Formal sources of finance (Banks)
Commercial Banks loan
Overdraft
Term loans
Explained 70.6% of the variance (KMO.71; Chronbac alpha .79)
Factor 2. 1: Informal sources of finance
Gifts and remittances
Windfall gain-inheritance
Windfall gain-lottery
Cooperative society
Microfinance NGO banks
Rotating savings/contributions (ajo/adache)
Moneylenders
Advance payment
Credit purchase
Lease
Hire purchase
Explained 62.1% of the variance (KMO.93; Chronbac alpha .94).

Table 3: Regression results of external financial sources of resources for NMI

	Model 1	Model 2	Model 3
Constant	-8.535E17	-.244 (-2.869)**	-.255 (-2.981)**
Formal sources of finance	.162 (2.799)**	.156 (2.722)*	.157 (2.741)*
Informal sources of finance	.355 (6.129)***	.373 (6.463) ***	.372 (6.443) ***
Controls			
Age		.124 (3.213)***	.108 (2.666)*
Size			.056 (1.395)
R^2	.238	.254	.257
Adjusted R^2	.235	.249	.251
F	79.391***	57.343***	43.574***

Note: ***, **,* denotes significance at 1%, 5% and10% respectively. Values of the t-statistics are indicated in parentheses. The sample size used for calculations is 510 KIBS SMEs. Reference categories for control variables are age 1-20yrs and size (average numbers of employees in 2006-2011).

The total variance explained by model 1 (r^2) is 23.8% and the F-value is .79.39 with overall statistical significance at p<.01. In model 2, while controlling for firm-age, 25.4% of the variance in a KIBS SMEs' ability to pioneer new market with formal and informal source of resources are explained and the F-value is 57.34 at p <.01. In model 3, after controlling for firm age and size, 25.7% of the total variance was explained with F-value as 43.57 at the significant level of p<.01. The F-ratio is highest at the base, however, it is still high at the instance of the control variables.

The regression result for this hypothesis shows a significant relationship between the use of external sources of financial resources and NMI. The overall result for the sample is in consonance with the previous empirical evidence on the relationship between external financial resources and difficulty to grow/ innovate (Myers, 1984; Kauffman, 2005). Nevertheless, it was unclear whether it is informal or formal strategies of external finance that may influence NMI. Hence, one part of this paper's contribution is that the informal strategies ofseeking finance rather than the formal sources of finances are more significantly associated to NMI. KIBS SMEs in Lagos seem to obtain finances more from the use of informal strategies between the years 2006-2011 for NMI. The more finances the KIBS SMEs were able to get from the informal sources of finance (non-banks) the more they were able to open new markets.

The data collected on external sources of finances in Lagos assisted in examining the association between external strategies of finance and NMI and also explored which of the institutions: formal or informal are used by KIBS SMEs during the years 2006-2011 to obtain finances for NMI. The results indicated that external finance is positively correlated with NMI possibly for its significance for firm growth and innovative activities. This is in consonance with the general findings by previous researches (Howorth, 2001; Beck and Demirguc-kunt, 2006), however, the findings of this study specifically deviates from them by identifying the particular source of external finance whether it is the formal or informal sources that is used for NMI in developing economies (Aryeetey, 2008).

The result showed that although formal finance (commercial banks) is significant (p<.10), the informal finance showed a higher significance (p<.001). This reveals that KIBS SMEs in Lagos obtained external financial resources for NMI more from non-banks sources like gifts and remittances, cooperative societies, rotating savings, moneylenders, lease and hire purchase which are mainly informal sources. This study contributes to the literature on financing market innovation and the institutional theory of entrepreneurship in emerging countries, by providing a better understanding that KIBS SMEs financial strategy is basically in getting finances for NMI from informal sources more than from formal sources.

Previous studies by McKinnon et al. (2007) on Ghana, Ndukwe (2005) on Nigeria, and Bagachwa (1996) on Tanzania pioneered work on the existence of formal and the informal financial sectors in Africa. In 2008, Aryeetey built on this by investigating the size and growth of informal sector and found that the sector is growing. However, this study does not only confirm that the formal and informal institutions exist in developing economies but the uniqueness in contributing to literature on new market innovation, SMEs' finance, institution theory and developing economy in its discovery.

In view of the bank reforms leading to the amalgamation of some commercial banks in Nigeria (Sanusi, 2011), bank services are becoming sophisticated for SMEs to services. Mambula (2002) asserted that Nigerian's infrastructures seem to give little support to domestic firms' in reality. Finance is unequally a significant barrier for high-growth firms like KIBS SMEs when compared to other enterprises because of their propensity for innovation through NMI. Therefore, the informal sources seemed to become more prominently the next option for KIBS SMEs innovative activities. This is also in congruence with Aryeetey's (2008) report that many analysts estimated that the informal financial sector is wider than the formal because of its accessibility to most socio-economic groups. Furthermore, Straub (2005) observed that there are larger informal sectors where the institutional quality is low and being formal entails costs to SMEs in such an environment. This information is extended by pinning down the informal financial resources to the firm level in this study rather than at the industry level (Aryeetey, 2008; Ayyagari, Demirgüç-Kunt, & Maksimovic, 2010; Okpara, 2010).

Additionally, this can be broadened to acquiring financial resources by young KIBS SMEs firms for NMI which has received little attention in the past unlike new start-ups (Babalola, 2009; Oyefuga, Siyanbola, Afolabi, & Dada, 2008). KIBS SMEs in Lagos obtained finances more from the informal sources for NMI in the research period. Marx (2004)emphasized that Nigeria informal financial sector is dynamic and the key to growth is by developing it. Thus, in answering the research question, from the analysis, the use of external sources of financial resources is positively associated with NMI by KIBS SMEs in Lagos. The more the use of external financial resources, the more they are able to pioneer new markets. Distinctively, from the findings of this study, the more finance KIBS SMEs are able to source from the informal sources in comparison to formal sources the more they are able to open new markets.

5.0 CONCLUSIONS AND IMPLICATIONS

This paper examined the relationship between the strategies for external finance and NMI. The data collected on external sources of finances in Lagos assisted in examining the relationship; and also explored which of the institutions: formal or informal are used by KIBS SMEs during the years 2006-2011 to obtain finances for NMI. The results reveal that external finance is positively correlated with NMI possibly for its significance for firm growth and innovative activities. However, the result showed that although formal finance (commercial banks) is significant (p<.10), the informal finance showed a higher significance (p<.001). This indicates that KIBS SMEs in Lagos obtained external finance for NMI more from non-banks sources like gifts and remittances, cooperative societies, rotating savings, moneylenders, lease and hire purchase which are mainly informal sources. However, this study does not only confirm that the formal and informal institutions exist in developing economies but the uniqueness in contributing to literature on new market innovation, SMEs' finance, institution theory and developing economy in its discovery that KIBS SMEs basically get finances for NMI from informal sources more than from formal sources.

The implications for policy makers:

- The informal system should be acknowledged as an integral part of the institutional system influencing innovation in emerging economies thus governments in developing countries should give cognisance to informal structures in the economy and extend their arms not just to the cooperative societies and microfinance banks only but to other informal organizations in the system.

- Training opportunities like workshops, conferences and seminar should be provided for personnel that are involved in informal institutions for empowerment and make funding opportunities available in view of the great work being done by them in supporting and promoting entrepreneurship.

- Funds should be made available to universities and research institutes to investigate and make knowledge resources available for pioneering KIBS SMEs.

- Nigeria has a national policy to foster innovation by NMI which includes incentives and motivations for NMI by SMEs. However, it might be necessary to revise the policy so as to provide direction by inclusion of informal sources for external resources of financialresources for NMI. This will give the informal sources a sort of legitimacy for KIBS SMEs patronage which in turn will foster growth and innovation through NMP.

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