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CONTENTS

THE IMPACT OF FINANCIAL RISKS ON THE DEVELOPMENT OF REGIONAL ECONOMIC GROWTH DRIVERS AND OPPORTUNITIES FOR THEIR MITIGATION	17
Turopova Nigora Xolmurod qizi	
UTILIZATION OF INTERNAL RESERVES FOR INCREASING THE EFFICIENCY OF REGIONAL TOURISM (CASE STUDY OF THE REPUBLIC OF KARAKALPAKSTAN)	20
Naurizbaev Aliakbar Rustamovich	
MATHEMATICAL MODELS AND ALGORITHMS FOR PROCESSING NOISE DATA	23
Jovlieva Dilnoz Mustofa qizi	
ASSESSMENT OF THE IMPACT OF ENVIRONMENTAL RISKS IN BUSINESS ACTIVITIES AND WAYS TO REDUCE THEM.....	28
Abdukhamid Abdumalikovich Bektemirov	
A MULTI-LEVEL SYSTEM OF STATISTICAL INDICATORS FOR REGIONAL TRANSPORT INFRASTRUCTURE ASSESSMENT: METHODOLOGY AND APPROBATION	34
Keunimzhaev Mukhamedali Kuanyshaevich	
THE IMPACT OF BANKS ON THE FINANCIAL STABILITY OF THE ECONOMY OF THE REPUBLIC OF UZBEKISTAN	39
Usmonov Faridun Firdavsievich, Ishonkulova Feruza Asatovna	
EMPIRICAL EVALUATION OF MACRO- AND MICROECONOMIC FACTORS AFFECTING THE EFFICIENCY OF INVESTMENT ACTIVITY AND THEIR RELATIONSHIP WITH ECONOMIC EFFICIENCY	43
Aytmuratova Ulbike Jalgasovna	
MECHANISMS FOR IMPROVING ECONOMIC EFFICIENCY THROUGH OPTIMIZATION OF PRODUCTION RESOURCE POTENTIAL IN UZBEKISTAN	47
Sattarov Abdusamat Umirqulovich	
PROMISING DIRECTIONS FOR APPLYING FOREIGN EXPERIENCE IN THE DEVELOPMENT OF GREEN TOURISM IN UZBEKISTAN	52
Rakhimova Dilfuza Mirzakasimovna	
PRIORITIES FOR REGULATING FINANCIAL RELATIONS IN PROVIDING HOUSING TO THE POPULATION IN UZBEKISTAN.....	58
Khannarov Komiljon Karimovich	
MPROVING THE ORGANIZATION OF PRODUCTION COST ACCOUNTING IN FULL-SYSTEM FARMS SPECIALIZING IN THE CULTIVATION OF CYPRINID FISH.....	62
Aitimbetov Amirbek Qoishibekovich	
THE TRANSFORMATIONAL ROLE OF SMALL BUSINESS IN UZBEKISTAN'S ECONOMIC DEVELOPMENT: A COMPREHENSIVE ANALYSIS BASED ON 2025 NATIONAL STATISTICS.....	68
Isakjanova Sabokhat Muhamedovna	
AN INTEGRATED METHODOLOGICAL FRAMEWORK FOR ADVANCING GREEN TOURISM MODELS IN THE DIGITAL ECONOMY ERA.....	79
Rasulova Nigora Yusupovna	
FACTORS AFFECTING THE COMPETITIVENESS OF COMPANIES.....	83
Kamoliddinov Ilhomjon Muhammadjonovich, Nosirov Eldor Nosirjon ugli	
THE ROLE OF INDUSTRIAL ENTERPRISES IN INCREASING THE EXPORT POTENTIAL OF THE UZBEK ECONOMY.....	88
Musayeva Shoira Azimovna	
DEVELOPMENT OF MARKET FACTORS TO ENSURE THE GROWTH OF THE ECONOMIC POTENTIAL OF THE ENTERPRISE (USING THE EXAMPLE OF THE SAG EXPRESS BRAND STORES)	92
Usmonova Dilfuza Ilkhomevna	
THE CONCEPT OF REGIONAL IMAGE AND ITS ECONOMIC CONTENT (THE CASE OF THE KHOREZM REGION).....	99
Dilshod Ibragimovich Ibdullayev	

DEVELOPMENT OF QUALITY MANAGEMENT SYSTEMS IN THE CONTEXT OF DIGITAL TRANSFORMATION	106
Shakhnoza Samandarovna Ziyadillayeva	
ADVANCED APPROACHES TO THE ASSESSMENT AND MANAGEMENT OF CURRENT FINANCIAL STABILITY IN JOINT-STOCK COMPANIES USING CFAR (CASH FLOW AT RISK) AND 3 Σ STATISTICAL RISK MODELS	114
Kurbonov Xayrilla	
DEVELOPMENT OF A PROGRAM FOR ANALYZING MEDICAL LABORATORY RESULTS USING ARTIFICIAL INTELLIGENCE MODELS.....	118
Gofurjonov Muhammadali, Kamolov Shamsiddin	
APPLICATION OF DIGITAL TRANSFORMATION IN IMPROVING MANAGEMENT STRATEGIES OF CONSTRUCTION MATERIALS INDUSTRY ENTERPRISES.....	122
Ubaydullayev Mukhammadjon Abdusamad o'g'li	
IMPROVING MECHANISMS FOR ENHANCING THE RESOURCE POTENTIAL OF ORGANIZATIONS IN THE EDUCATIONAL SERVICES SECTOR.....	125
Ibrohim Meliboyev	
ECONOMETRIC ANALYSIS OF THE RELATIONSHIP BETWEEN SERVICE QUALITY AND ECONOMIC EFFICIENCY.....	130
Khudoyorov Lochinbek Bahromovich	
MONETARY POLICY INSTRUMENTS IMPROVE USAGE PRACTICES	135
A.A. Ismailov	
E-COMMERCE ADOPTION IN TRADITIONAL STORES.....	140
Nuserov Bakhtiyor	
ENHANCING FINANCIAL SUSTAINABILITY AND OPERATIONAL EFFICIENCY OF JSC "HUDUDGAZTAMINOT": KEY FACTORS AND DIGITAL TRANSFORMATION STRATEGIES.....	146
Ergashev Muhibbek Aslamovich	
METHODS FOR IMPROVING AUTOMOTIVE FUEL QUALITY INDICATORS THROUGH THE USE OF ADDITIVES.....	151
Xushnayev Obid, Sheraliyev Ulugbek, Astonov Alisher	
MONETARY POLICY INSTRUMENTS.....	156
A.A. Ismailov	
THE ROLE OF STRATEGIC MANAGEMENT IN ENHANCING A COUNTRY'S INTERNATIONAL IMAGE: THE CASE OF SWITZERLAND.....	161
Idirisbaeva Hurliman Amanbay qizi, Kurolov Maksud Obitovich	
VOLUNTEER TOURISM: CURRENT IMPACTS AND FUTURE DIRECTIONS	170
Ossama Moustafa Elsetouhy	
COMPUTER GRAPHICS IN MODERN EDUCATION: PRACTICAL CAPABILITIES OF THE FIGMA PLATFORM.....	176
Maxamadov Rustam Xabibullayevich, Djamatov Mustafa Xatamovich	
DEVELOPING THE FINANCIAL SUSTAINABILITY OF HIGHER EDUCATION INSTITUTIONS BASED ON DIGITAL TECHNOLOGIES.....	182
Abdurasulov Sardor Tolqin ugli	
THE IMPORTANCE AND PROSPECTS OF TOURISM DEVELOPMENT	187
Ibodova Dilsora Ibodovna, Qosimov Jahongir Ruziboyevich	
STRATEGIES FOR OPTIMIZING THE STRUCTURE OF COMMERCIAL BANK ASSETS AND INCREASING EFFICIENCY IN UZBEKISTAN	194
Ibrohimov Davronbek Muhammadi o'g'li	
STRATEGIC DIRECTIONS FOR THE DEVELOPMENT OF EXPORTS OF PRODUCTS BASED ON ARTIFICIAL FIBERS.....	199
Raximov Furqat Jalolovich	
FUNDAMENTALS OF USING MARKETING RESEARCH TO IMPROVE SALES SYSTEM EFFECTIVENESS.....	206
Abduxalilova Laylo Tuxtasinovna	

FASHION MARKETING AS AN INSTRUMENT FOR SHAPING CONSUMER-BASED BRAND VALUE.....	213
Navruz-Zoda Bakhtiyor Negmatovich, Aripova Makhliyo Salakhiddinovna	
ENSURING SUSTAINABLE GROWTH OF THE NATIONAL ECONOMY IN THE CONTEXT OF DIGITAL TRANSFORMATION, IMPROVING INNOVATIVE DEVELOPMENT STRATEGIES, AND ENHANCING THE EFFICIENCY OF IMPLEMENTING DIGITAL ECONOMY PRINCIPLES IN THE FINANCE, BANKING, AND TOURISM SECTORS	220
Inatullayeva Intizor Jamshid qizi, Uroqov Uchqun Yunusovich	
SOCIAL AND SECURITY PROBLEMS OF INNOVATIVE TOURISM DEVELOPMENT IN THE REGION.....	223
Q.A. Musakhanov	
DIGITAL ECONOMY AND INNOVATION AS FACTORS OF SOCIAL DEVELOPMENT IN UZBEKISTAN	228
Ibragimova Saodat Abdumuminovna, Sadullayeva Sevara Uchqun qizi	
THE SOCIAL INSURANCE SYSTEM OF THE UNITED STATES OF AMERICA	232
Javliyev Nuriddin Bektemir o'g'li	
DEVELOPMENT OF EFFECTIVE ORGANIZATIONAL-ECONOMIC MECHANISMS FOR TRANSITION TO THE INNOVATIVE MARKETING CONCEPT IN ENTERPRISES UNDER DIGITAL TRANSFORMATION	236
Bobomurodov Qayimjon Homidovich	
FOMO-DRIVEN PURCHASING IN E-COMMERCE FLASH SALES: AN INTEGRATIVE CONCEPTUAL FRAMEWORK	241
Muhammadimov Abdukodir Bakhodirjon Ugli, Arciana Damayanti, Javliev Nuriddin Bektemir ugli	
PHYSICO-MECHANICAL PROPERTIES OF COARSE FEEDS	250
Yodgorov Jamoliddin Nomozovich, Yadgarov Sirojiddin Nomozovich	
EVOLUTION AND STANDARDIZATION OF SI MEASUREMENT UNITS IN THE INTERNATIONAL SYSTEM	255
Maxmudov Dostonbek Soyibjon o'g'li	
PROCEDURE FOR ACCOUNTING OF ESTIMATED LIABILITIES BY BUDGETARY ORGANIZATIONS	259
Jabbarova Charos Aminovna	
FEATURES OF AUDIT IN DEVELOPING INVESTMENT LENDING PRACTICES IN COMMERCIAL BANKS.....	263
Jamshid Mirzakhmedov	
ECONOMIC EFFICIENCY OF RENEWABLE ENERGY SOURCES: THE CASE OF SOLAR AND WIND ENERGY	271
Hayitov Jamshid Kholboyevich	
ADVANCED FOREIGN EXPERIENCE IN HIGHER EDUCATION FINANCING: THE CASE OF THE UNITED KINGDOM	275
Kurbanov Baxodir Negmatullayevich	
THE IMPACT OF DIGITAL DESTINATION IMAGE ON TOURIST SATISFACTION AND REVISIT INTENTION: EVIDENCE FROM UZBEKISTAN	279
Shaxnoza Almasovna Ashurova	
METHODS OF THEORETICAL ANALYSIS OF METAL FORMING PROCESSES.....	279
Rakhimov T.O., Norboyev Abror Baxtiyor o'g'li	
THE ROLE OF DEVELOPING THE GREEN DEPOSIT SYSTEM IN BANKS WITHIN STATE FINANCIAL POLICY.....	287
Maxmudov Rahimjon Hamid o'g'li	
MODERN APPROACHES TO MANAGING INNOVATIVE ACTIVITY IN THE DIGITAL ECONOMY.....	293
Saipova Dilnoza Shuxratovna	
FINANCING SMALL BUSINESSES AND MECHANISMS FOR ATTRACTING INVESTMENTS	299
Xakimov Akbar Anvarovich	

FINANCING SMALL BUSINESSES AND MECHANISMS FOR ATTRACTING INVESTMENTS

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Annotatsiya. Ushbu maqolada kichik biznesni moliyalashtirish va investitsiyalarni jalb etish mexanizmlari tadqiq etilgan. Unda kichik biznesni moliyalashtirishning nazariy yondashuvlari, jumladan, ichki va tashqi moliyalashtirish manbalari tahlil qilingan hamda investitsiyalardan foydalanish imkoniyatlarini kengaytirishda moliyaviy institutlar, davlat qo'llab-quvvatlash dasturlari va xususiy investorlarning o'rni yoritilgan. Shuningdek, investitsion jozibadorlikka ta'sir etuvchi asosiy omillar, ya'ni biznes muhiti, risk darajasi, rentabellik va huquqiy me'yorlar ko'rib chiqilgan. Kichik biznes sohasiga kapital oqimini kuchaytiruvchi zamonaviy moliyaviy instrumentlar va strategiyalarga alohida e'tibor qaratilgan. Tadqiqot natijalari samarali moliyalashtirish mexanizmlari kichik korxonalarining barqaror rivojlanishi va raqobatbardoshligini ta'minlashda muhim ahamiyatga ega ekanligini ko'rsatadi.

Kalit so'zlar: kichik biznes, moliyalashtirish mexanizmlari, investitsiyalarni jalb etish, moliyaviy institutlar, investitsion muhit, kapital, davlat qo'llab-quvvatlashi, xususiy investitsiyalar, moliyaviy instrumentlar, iqtisodiy rivojlanish.

Аннотация. В данной статье исследуются механизмы финансирования малого бизнеса и привлечения инвестиций. Проанализированы теоретические подходы к финансированию малого бизнеса, включая внутренние и внешние источники финансирования, а также раскрыта роль финансовых институтов, государственных программ поддержки и частных инвесторов в расширении доступа к инвестициям. Рассмотрены ключевые факторы инвестиционной привлекательности, такие как деловая среда, уровень риска, рентабельность и правовые нормы. Особое внимание уделено современным финансовым инструментам и стратегиям, способствующим увеличению притока капитала в сектор малого бизнеса. Результаты исследования показывают, что эффективные механизмы финансирования имеют важное значение для устойчивого развития и конкурентоспособности малых предприятий.

Ключевые слова: малый бизнес, механизмы финансирования, привлечение инвестиций, финансовые институты, инвестиционный климат, капитал, государственная поддержка, частные инвестиции, финансовые инструменты, экономическое развитие.

Abstract. This article examines the mechanisms of financing small businesses and attracting investments. It analyzes theoretical approaches to small business financing, including internal and external funding sources, and highlights the role of financial institutions, government support programs, and private investors in improving access to investment resources. The study also explores the key factors influencing investment attractiveness, such as the business environment, risk level, profitability, and legal frameworks. Special attention is given to modern financial instruments and strategies that enhance capital inflows into the small business sector. The findings emphasize that effective financing mechanisms are essential for the sustainable development and competitiveness of small enterprises.

Keywords: small business, financing mechanisms, investment attraction, financial institutions, investment climate, capital, government support, private investment, financial instruments, economic development.

INTRODUCTION

Small businesses play a crucial role in the economic development of both developed and developing countries. They contribute significantly to employment generation, innovation, income distribution, and overall economic growth. In a rapidly changing global economy, ensuring adequate financing and attracting investment for small business entities has become a key priority for policymakers and economic researchers.

Financing small businesses is often challenging due to limited internal resources, a lack of collateral, and the higher level of risk perceived by financial institutions. As a result, external funding sources such as bank loans, microfinance institutions, venture capital, and government support programs become essential

for their sustainability and expansion. At the same time, attracting investment requires a favorable business environment, a stable legal framework, and effective financial mechanisms that strengthen investor confidence.

Understanding the theoretical foundations of small business financing and investment attraction is important for developing effective economic policies and improving access to capital. Therefore, this article aims to examine the main mechanisms of financing small businesses and analyze the key factors influencing investment attraction in this sector.

LITERATURE REVIEW

The financing of small businesses and the mechanisms for attracting investment have been widely discussed in economic and financial literature due to their important role in economic development, employment creation, and innovation. Theoretical and empirical studies emphasize that small business finance is characterized by a high dependence on external funding sources, information asymmetry, and a higher perceived level of risk compared to large enterprises.

One of the fundamental theoretical approaches in small business finance is the **financial growth cycle theory**, which explains how firms change their financing structure as they develop over time. According to this theory, small and young firms rely heavily on internal funds, family support, trade credit, and informal financing sources, whereas more mature firms gain access to bank loans, venture capital, and eventually public capital markets. This framework highlights the dynamic nature of financing decisions and the importance of firm size, age, and transparency in determining access to capital¹.

Another important contribution comes from the **pecking order theory**, which suggests that firms prefer internal financing first, then debt financing, and finally equity financing due to asymmetric information and transaction costs. In the context of small businesses, this theory is particularly relevant because these firms often face greater borrowing constraints and limited access to equity markets, making external financing more expensive and difficult to obtain.

Institutional and network-based theories also play a significant role in explaining investment attraction. Studies show that the development of strong institutional frameworks, legal stability, and efficient financial systems increases investor confidence and improves access to capital for small businesses. In addition, social capital and business networks facilitate financing by strengthening trust between entrepreneurs and investors, reducing information asymmetry, and expanding access to financial resources.

Foreign Direct Investment (FDI) and investment attraction theories further emphasize the importance of ownership advantages, location advantages, and internalization advantages, commonly known as the OLI paradigm. These factors influence how and why investors choose specific small business environments, especially in developing economies where institutional conditions are still evolving².

Empirical studies confirm that small business financing is strongly influenced by firm-specific factors such as profitability, firm size, export orientation, and research and development intensity. External factors, including macroeconomic stability, government support policies, and access to financial institutions, also significantly affect investment attraction and capital inflows. Research further demonstrates that well-developed financial markets and supportive public policies improve the survival rate and growth potential of small enterprises.

Despite the extensive body of literature, several gaps remain. Many studies focus primarily on large enterprises, whereas financing mechanisms for small businesses in developing economies are still insufficiently researched. In particular, issues such as financial constraints, investment risk perception, and the role of digital financial technologies require further investigation.

Overall, the literature indicates that financing small businesses and attracting investment is a multidimensional process influenced by financial theories, institutional conditions, and firm-level characteristics.

RESEARCH METHODOLOGY

This study on the financing of small businesses and the mechanisms for attracting investment is based on a qualitative and analytical research approach. The methodology focuses on understanding theoretical concepts, reviewing existing literature, and analyzing economic models related to small business financing and investment attraction.

The research is primarily conducted using descriptive and comparative analysis methods, which allow for the examination of different theoretical perspectives such as the **Pecking Order Theory**, **Financial Growth Cycle Theory**, and **Institutional Theory**. These theories are compared in terms of their relevance to financing

1 Ribeiro-Soriano, D. (2017). Small business and entrepreneurship: Their role in economic and social development. *Entrepreneurship & Regional Development*, 29(1–2).

2 Bloom, N., Bond, S., & Van Reenen, J. (2007). Uncertainty and investment dynamics. *The Review of Economic Studies*, 74(2), 391–415.

constraints faced by small businesses and their influence on investment behavior.

In addition, the study applies a theoretical synthesis method to identify the most effective financing mechanisms and institutional factors that can improve access to capital and enhance investment attractiveness in the small business sector.

ANALYSIS AND RESULTS

One of the theories relevant to attracting investment in small businesses is the **Pecking Order Theory**, developed by Steven M. Fazzari, R. Glenn Hubbard, and Bruce C. Petersen. This model suggests that the sensitivity of investment to cash flow is an important indicator of financial constraints. According to the theory, external financing is more expensive and difficult to obtain than internal financing.

Ferrando and Ruggieri found in their research that the impact of financial constraints on efficiency is particularly high in small businesses. According to this theoretical approach, one of the most optimal strategies is to reinvest internal profits as a primary financing source. After that, firms may seek subsidies and bank loans. At the same time, transparent financial reporting increases opportunities to attract outside investors. This analysis is presented more clearly in **Table 1**.

Table 1
Analysis of the Theory of Financial Constraints³

Stage	Source of Funding	Features	Advantage
1	Retained earnings	Does not require external information disclosure	Independence is maintained
2	Bank loans	Standard documents and collateral required	Faster to obtain than equity financing
3	Equity (angel investors, VC, IPO)	Expensive and requires high transparency	Final option for business expansion or recovery

Another theory that positively influences the probability of attracting investment in small businesses is **Institutional Theory**. One of the major contributors to this theory is Douglass C. North. According to this approach, institutions such as laws, regulations, and property rights shape the behavior of economic agents. Strong institutions reduce transaction costs and uncertainty, thereby improving investment opportunities for small businesses.

C. Bjørnskov and N. J. Foss tested North’s theory through empirical research and concluded that institutional factors have a positive effect on small business development. According to their findings, high-quality institutions can increase small business activity by **25–35%** and strengthen social trust. Lower transaction costs also improve investment flows. The institutional mechanism is illustrated below in **Figure 1**.

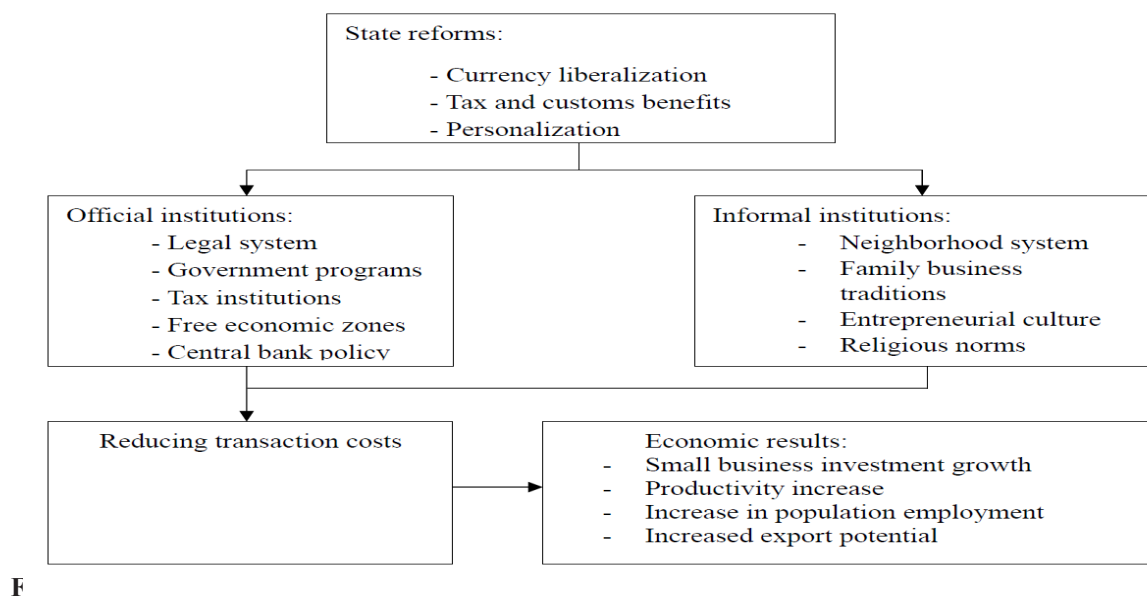


Figure 1. Institutional Mechanism for Small Businesses¹

3 Author’s development.
4 Author’s development.

Another theory relevant to small businesses is the **Resource-Based Theory**, proposed by Jay B. Barney. This theory considers business performance to be based on strategic resources evaluated through the **VRIO** criteria: **Valuable, Rare, Imperfectly Imitable, and Organized**. Through the effective use of such resources, small businesses can strengthen their competitive advantage and attract potential investors.

Seitz and fellow researchers examined this theory in relation to business accelerators and analyzed the unique resources that accelerators can provide to small enterprises. Their findings showed that accelerators positively influence growth orientation by supplying valuable resources to small businesses. Therefore, this theory is highly important in explaining investment attraction in the small business sector.

The key resources based on the VRIO framework for small businesses are presented in **Table 2**.

Table 2
Resources Based on Barney's VRIO Criteria for Small Businesses⁵

Resource Type According to VRIO	Feature	Interested Investors
Human capital	Competence (unique knowledge, skills, abilities, and experience)	Business angels, venture capitalists, strategic investors, banks
Technology	Patent ownership and non-copyable innovations	
Customer base	Long-term and loyal customers	
Location	Low competition and strategic market position	
Product and personal brand	Trust and reputation	
Partnerships	Broad professional and business network	

In general, the more unique resources a small business possesses, the higher its potential to attract investment.

Another important source of financing for small businesses is provided by **business angels**. A business angel is a high-net-worth investor who provides funding through personal capital, family and close social networks, or formal angel investor networks. The primary target of this type of financing is newly established startups or small businesses with high market potential. In most cases, the investment model is equity-based.

This financing source emerged to fill the gap between traditional bank lending and large-scale venture capital financing. Mason and Harrison introduced the concept of the **equity gap**, which refers to the shortage of financing available for small and growing firms. In this regard, business angels are considered particularly effective during the **seed** and **early growth** stages of small businesses.

The process of attracting business angels generally consists of the following stages:

Developing a business plan. A business plan designed for angel investors must be comprehensive, realistic, and well-justified.

Accessing angel investment platforms. Entrepreneurs should participate in networks and platforms where business angels operate.

Negotiating with investors. Effective negotiation is necessary to agree on investment conditions and partnership terms.

In general, business angels provide not only capital, but also networking opportunities, managerial experience, and increased credibility for obtaining bank loans or participating in government support programs in the future.

CONCLUSIONS AND RECOMMENDATIONS

This research examined the theoretical foundations of attracting investment to small businesses based on investment theories, traditional and modern financing sources, and the scientific views of leading scholars. These approaches can serve as a theoretical framework for increasing sustainability in small business financing.

The study of financing small businesses and mechanisms for attracting investment demonstrates that access to financial resources is a fundamental condition for sustainable business development and economic growth. Small enterprises, despite their substantial contribution to employment generation and innovation, often face serious financial constraints that limit their expansion and competitiveness.

The findings confirm that both internal and external financing sources play an important role in supporting small businesses. Internal resources alone are usually insufficient for long-term growth; therefore, external financing mechanisms such as bank loans, microfinance institutions, venture capital, and government support programs are essential.

5 Author's development.

It is also concluded that investment attraction largely depends on the overall economic environment, institutional stability, and the quality of a country's financial infrastructure. A transparent legal system, supportive government policies, and efficient financial markets significantly increase investor confidence and improve capital inflows into the small business sector.

Moreover, firm-specific factors such as profitability, innovation capacity, managerial efficiency, and market orientation strongly influence the ability of small businesses to attract investment. Companies that demonstrate growth potential and financial transparency are more likely to gain access to external funding.

Overall, the study shows that improving financing mechanisms for small businesses requires a comprehensive approach that combines financial reforms, institutional development, and the introduction of modern financial technologies. Strengthening these areas will contribute to the long-term development and competitiveness of small enterprises in both domestic and international markets.

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