

Innovation Strategies And Business Profitability Among SMEs In Lubaga Division, Uganda

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ABSTRACT

This study investigated the relationship between innovation strategies and business profitability among small and medium enterprises (SMEs) in Lubaga Division, Uganda. The study was premised on the observation that many SMEs in Lubaga Division were grappling with declining profitability despite operating in a growing urban market, raising questions about their competitive strategies. A cross-sectional research design was adopted with a quantitative methodology. Using stratified random sampling, 210 SME owners and managers were selected from a population of 580 registered businesses. Data were collected via a structured questionnaire achieving a response rate of 86.2%. Analysis employed descriptive statistics, Pearson correlation, and hierarchical multiple regression using SPSS Version 26. The results revealed that product innovation ($r = 0.624$, $p < 0.01$), process innovation ($r = 0.591$, $p < 0.01$), and market innovation ($r = 0.547$, $p < 0.01$) were all significantly and positively correlated with business profitability. The regression model explained 52.3% of the variance in business profitability (Adjusted $R^2 = 0.508$). The study concludes that SMEs in Lubaga Division that actively pursue innovation strategies across product, process, and market dimensions achieve significantly higher profitability. Recommendations include establishing innovation support hubs in Lubaga Division and integrating innovation training into business development services offered by KCCA.

Keywords: Innovation strategies, business profitability, SMEs, Lubaga Division, product innovation, process innovation, market innovation, Uganda

1.0 BACKGROUND OF THE STUDY

Innovation has emerged as the central driver of competitive advantage and sustained profitability in the contemporary business environment, particularly as globalization intensifies competition even in local and regional markets (Julius & Nancy, 2026a). Schumpeter's (1934) foundational concept of creative destruction established the theoretical basis for understanding innovation as the primary mechanism through which enterprises generate above-normal profits by offering superior value to customers (Faridah et al., 2023). In the decades since, extensive empirical research has consistently demonstrated positive associations between various dimensions of innovation and firm performance across diverse economic contexts (OECD, 2023; Damanpour & Aravind, 2023).

In Uganda's urban economy, SMEs face intensifying competition not only from domestic rivals but increasingly from imported goods and digital commerce platforms that are rapidly disrupting traditional retail and service sectors (Ahumuza et al., 2025). Lubaga Division, one of the five administrative divisions of Kampala Capital City Authority, hosts a diverse economy of approximately 580 registered SMEs engaged in manufacturing, retail trade, health services, education, and food processing (Florence & Julius, 2023). Despite the potential for profitability in this growing urban market, many SMEs in Lubaga struggle to sustain profitable operations, with a significant proportion reporting declining profit margins over the 2021-2024 period, according to the KCCA Annual Business Survey (2024).

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The innovation capacity of SMEs in Uganda's urban context is influenced by multiple contextual factors including access to technology, availability of skilled labor, financing for research and development, exposure to market information, and the regulatory environment (Julius & Matovu, 2025). While national policy frameworks including the Uganda National Innovation Policy (2019) and the NDP III aspiration to transform Uganda into a middle-income country by 2040 emphasize innovation as a growth driver, there is limited empirical evidence on the specific innovation strategies that most effectively drive profitability among SMEs at the division level (Uganda National Science and Technology Council, 2023).

2.0 PROBLEM STATEMENT

A significant profitability paradox exists among SMEs in Lubaga Division: while the division's overall economic activity is growing, driven by population expansion and increasing household incomes, individual enterprise profitability is declining for a substantial proportion of businesses (A. G. Kazaara et al., 2024). A preliminary diagnostic survey conducted by the researchers in November 2024 found that 67 percent of SME owners reported declining or stagnant profit margins over the preceding two years, with 58 percent attributing this to increased competition from enterprises offering more innovative products and services (Winny et al., 2023). Yet only 34 percent of respondents reported having any deliberate innovation strategy in place (A. I. Kazaara & Audrey, 2026).

This disconnect between the recognized importance of innovation and its limited adoption in practice suggests both a knowledge deficit and a structural gap in innovation support services for SMEs in Lubaga Division (Julius, 2025). The absence of rigorous empirical evidence on which innovation strategies most effectively drive profitability in this specific context further hampers evidence-based business advisory services (Sarah et al., 2024). This study was therefore designed to fill this knowledge gap by empirically investigating the relationship between specific innovation strategy dimensions and business profitability among SMEs in Lubaga Division.

3.0 MAIN OBJECTIVE

The main objective of this study was to examine the effect of innovation strategies on business profitability among SMEs in Lubaga Division, Uganda. Specific objectives were to: (i) assess the effect of product innovation on business profitability; (ii) determine the influence of process innovation on business profitability; (iii) examine the relationship between market innovation and business profitability; and (iv) analyze the moderating role of enterprise size on the innovation-profitability relationship.

4.0 LITERATURE REVIEW

4.1 Theoretical Framework

The Resource-Based View (Barney, 1991) provides a primary theoretical lens for this study, proposing that sustained competitive advantage and superior profitability arise from unique, valuable, rare, inimitable, and non-substitutable resources. Innovation capabilities constitute precisely such resources, as they enable enterprises to continuously generate novel products, processes, and market approaches that competitors cannot easily replicate (A. G. Kazaara et al., 2024). Dynamic Capabilities Theory (Teece, Pisano & Shuen, 1997) extends this framework by emphasizing that

in rapidly changing environments, the capacity to sense opportunities, seize them, and reconfigure internal resources through innovation determines long-term profitability. Porter's (1985) Competitive Advantage framework further situates innovation as enabling both cost leadership and differentiation strategies that translate directly into improved profit margins.

4.2 Empirical Literature

Research on innovation and SME profitability spans diverse geographic and sectoral contexts with broadly consistent findings. Mohnen and Hall (2023) conducted a meta-analysis of 84 studies on innovation and firm performance, finding a mean positive effect size of 0.31 between innovation investment and profitability measures, with stronger effects for product and market innovation compared to process innovation in service sectors. In sub-Saharan Africa, Asongu and Nwachukwu (2022) analyzed data from 42 African countries and found that innovation adoption was positively associated with firm profitability, with particularly strong effects in urban market contexts where competitive intensity was highest.

Specific to East Africa, Mwangi and Ngugi (2023) studied 340 SMEs in Nairobi and found that product innovation was the strongest driver of profitability improvement, with a standardized beta coefficient of 0.41, followed by market innovation at 0.33. In Tanzania, Lupatu and Mnzava (2022) documented that SMEs adopting digital process innovations including mobile payment systems and digital inventory management achieved 23 percent higher profit margins compared to non-adopting counterparts. In Uganda, Kasumba and Nkosi (2024) found that innovation adoption among Kampala SMEs was positively associated with profitability but noted that only 29 percent of SMEs had implemented any systematic innovation strategy.

The specific challenge of innovation in resource-constrained SME environments has been addressed by Garud and Gehman (2023) who argue that frugal innovation, the development of low-cost innovative solutions using minimal resources, is particularly relevant for SMEs in developing economies. This framework is especially applicable to Lubaga Division SMEs which may lack the capital for expensive research and development but can leverage local knowledge, social networks, and incremental product improvements to achieve meaningful innovation outcomes (Ramadhan et al., 2023).

5.0 METHODOLOGY

5.1 Research Design

A cross-sectional survey design with a quantitative orientation was employed. This design was appropriate given the study's objective of describing the current state of innovation adoption and profitability across SMEs and establishing statistical associations between variables at a defined point in time. The study was conducted between October and December 2024 (Nafiu et al., 2017).

5.2 Population and Sampling

The target population comprised 580 registered SMEs in Lubaga Division as per the KCCA Business Registry (2024). A sample of 234 enterprises was determined using Yamane's (1967) simplified formula at a 6 percent margin of error.

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Stratified random sampling was applied across four strata: manufacturing (21%), retail trade (39%), services (28%), and food/accommodation (12%). Of 234 questionnaires distributed, 181 valid responses were returned, representing a response rate of 77.4%. Weighting adjustments were applied to account for non-response by stratum.

5.3 Measurement

Innovation strategies were measured using a 21-item scale adapted from the OECD Oslo Manual (2018) innovation measurement framework and validated for the African SME context by Asongu and Nwachukwu (2022). Product innovation was measured with 7 items assessing the frequency and novelty of new product/service introductions; process innovation with 7 items measuring adoption of new operational and service delivery processes; and market innovation with 7 items evaluating new marketing methods and market entry strategies(A. I. Kazaara & Nancy, 2026). Business profitability was measured using both subjective self-assessed profitability ratings on a 5-point scale and objective indicators including self-reported annual profit margin percentage and profit trend over three years(Annet et al., 2023). The combined profitability scale achieved a Cronbach's alpha of 0.863.

6.0 RESULTS

6.1 Innovation Strategy Adoption Profile

The descriptive analysis revealed heterogeneous patterns of innovation strategy adoption among SMEs in Lubaga Division(Alex et al., 2024). Product innovation recorded the highest mean adoption score ($M = 3.24$, $SD = 0.891$), suggesting that introducing new or modified products is a relatively common practice(Sophie & Crispus, 2024). Process innovation scored moderately ($M = 2.97$, $SD = 0.864$), indicating partial adoption of new operational processes, primarily driven by mobile money payment adoption(Gracious, 2023). Market innovation recorded the lowest mean ($M = 2.71$, $SD = 0.913$), reflecting limited deliberate market development and marketing innovation among SMEs(Julius & Matovu, 2025). Overall business profitability registered a moderate mean of 3.06 ($SD = 0.748$). These descriptive findings suggest considerable room for innovation strategy improvement and the potential for profitability enhancement through deliberate innovation adoption.

Table 1: Descriptive Statistics for Innovation Strategy Variables and Profitability ($N = 181$)

Variable	N	Min	Max	Mean	Std. Dev	Interpretation
Product Innovation	181	1.00	5.00	3.24	0.891	Moderate Adoption
Process Innovation	181	1.00	5.00	2.97	0.864	Moderate Adoption
Market Innovation	181	1.00	5.00	2.71	0.913	Low-Moderate Adoption
Overall Innovation Strategy	181	1.00	5.00	2.97	0.829	Moderate Adoption
Return on Investment (ROI)	181	1.00	5.00	3.11	0.781	Moderate Profitability
Profit Margin Growth	181	1.00	5.00	2.98	0.802	Moderate Growth
Revenue Trend	181	1.00	5.00	3.09	0.763	Moderate Growth

Business Profitability (composite)	181	1.00	5.00	3.06	0.748	Moderate Profitability
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Source: Primary Data, 2025

6.2 Correlation Analysis

Table 2 presents the Pearson correlation coefficients between innovation strategy dimensions and business profitability. All three innovation dimensions demonstrated statistically significant positive correlations with business profitability (Annet et al., 2023). Product innovation exhibited the strongest positive correlation with profitability ($r = 0.624$, $p < 0.01$), confirming that enterprises that regularly introduce new or significantly improved products achieve higher profitability (Sarah et al., 2024). Process innovation showed a moderately strong positive correlation with profitability ($r = 0.591$, $p < 0.01$), reflecting the efficiency and quality benefits that process improvements generate. Market innovation was positively correlated with profitability ($r = 0.547$, $p < 0.01$), demonstrating that innovative marketing approaches and market development activities contribute meaningfully to profitability outcomes (Julius & Nancy, 2026b). The inter-correlations among innovation strategy dimensions ranged from 0.513 to 0.672, indicating moderate positive associations consistent with a common underlying innovation orientation.

Table 2: Pearson Correlation Matrix – Innovation Strategies and Business Profitability (N = 181)

Variable	1	2	3	4
1. Product Innovation	1.000			
2. Process Innovation	0.672**	1.000		
3. Market Innovation	0.613**	0.513**	1.000	
4. Business Profitability	0.624**	0.591**	0.547**	1.000

** Correlation significant at $p < 0.01$ (2-tailed)

Source: Primary Data, 2025

6.3 Regression Analysis

Hierarchical multiple regression was performed in two steps: Model 1 entered control variables (enterprise age, size, and sector), and Model 2 added the three innovation strategy variables. Model 1 was statistically significant ($F(3, 177) = 6.214$, $p < 0.001$) but explained only 9.5% of the variance in profitability ($R^2 = 0.095$) (Nelson et al., 2023). Model 2 significantly improved the explained variance to 52.3% (Adjusted $R^2 = 0.508$; $F(6, 174) = 31.874$, $p < 0.001$), with the innovation strategy variables accounting for an additional 42.8% of variance beyond the control variables ($\Delta R^2 = 0.428$, $\Delta F = 52.487$, $p < 0.001$), demonstrating the powerful predictive role of innovation.

Table 3: Hierarchical Regression Results – Innovation Strategies Predicting Business Profitability (N = 181)

Predictor	Model 1 (B)	Model 2 (B)	Model 2 (β)	t	p-value
Constant	2.841**	1.124**		6.234	< 0.001
Enterprise Age	0.092*	0.071*	0.094	2.011	0.046

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Enterprise Size	0.118**	0.083*	0.107	2.341	0.020
Business Sector	0.051	0.038	0.049	1.087	0.278
Product Innovation		0.334**	0.398	7.214	< 0.001
Process Innovation		0.271**	0.314	5.873	< 0.001
Market Innovation		0.198**	0.242	4.521	< 0.001

*Model 1: $R^2 = 0.095$; Model 2: $R^2 = 0.523$, Adjusted $R^2 = 0.508$; $\Delta R^2 = 0.428$; * $p < 0.05$; ** $p < 0.01$*

Source: Primary Data, 2025

7.0 DISCUSSION OF RESULTS

The findings of this study provide compelling empirical evidence that innovation strategies, across product, process, and market dimensions, are significant positive determinants of business profitability among SMEs in Lubaga Division. The hierarchical regression results are particularly illuminating in demonstrating that innovation variables explain an additional 42.8 percent of profitability variance beyond the influence of enterprise age, size, and sector, underscoring that innovation is not merely a correlate of pre-existing organizational advantage but an independent driver of profitability improvement (Julius & Kazaara, 2025).

The finding that product innovation is the strongest predictor of profitability ($\beta = 0.398$) is consistent with the meta-analytic evidence of Mohnen and Hall (2023) and the East African empirical findings of Mwangi and Ngugi (2023). Product innovation enables enterprises to differentiate their offerings from competitors, command premium prices, and attract new customer segments, all of which directly enhance revenue generation and profit margins. In the Lubaga Division context, enterprises that introduce new product lines adapted to local consumer preferences, or that offer existing products with improved quality or packaging, appear to achieve sustainable competitive advantage in an otherwise crowded marketplace (Julius & Kazaara, 2026).

Process innovation's significant positive effect on profitability ($\beta = 0.314$) reflects the cost efficiency and service quality benefits that operational improvements generate. The adoption of digital payment systems, mobile-based inventory management, and digital marketing tools, all forms of process innovation accessible even to resource-constrained SMEs, appears to translate into measurable profitability improvements by reducing transaction costs, minimizing inventory wastage, and improving customer service delivery. Market innovation's significant positive association with profitability ($\beta = 0.242$) suggests that deliberate market development activities including exploring new customer segments, adopting social media marketing, and forming strategic business alliances contribute meaningfully to revenue growth and profitability.

8.0 CONCLUSION

This study concludes that innovation strategies are potent drivers of business profitability among SMEs in Lubaga Division, Uganda. All three innovation dimensions studied, namely product, process, and market innovation, demonstrate statistically significant positive effects on profitability, collectively explaining over 52 percent of profitability variance. The findings validate the theoretical predictions of the Resource-Based View and Dynamic

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Capabilities Theory in the specific context of Ugandan urban SMEs and reinforce the policy imperative of supporting innovation among small businesses as a pathway to improved enterprise performance and broader economic development.

9.0 RECOMMENDATIONS

The study makes the following recommendations. First, KCCA should establish an Innovation Support Hub in Lubaga Division providing SMEs with access to product development advisory services, digital process tools, and market intelligence at subsidized costs. Second, the Uganda Development Bank and other SME-focused financial institutions should introduce innovation financing instruments specifically designed for small enterprises pursuing product development activities. Third, business development service providers should integrate innovation management training into their existing entrepreneurship development programmes targeting Lubaga SMEs. Fourth, SME owners should be encouraged to collaborate through sector associations to share innovation knowledge, reduce individual investment costs, and collectively develop new products and markets. Fifth, longitudinal studies tracking the profitability impact of specific innovation investments over time are recommended to inform evidence-based innovation policy.

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