

# VENTURING INTO SMALL BUSINESS IN A DEVELOPING ECONOMY: MOTIVATIONS AND CONSTRAINTS

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## 1. Introduction.

There is a growing body of opinion that bold and far-reaching structural reforms hold a panacea for the prevailing economic stagnation in most developing economies. These reforms which have been embraced in many, encompass social and economic dimensions. Euphemistically called "Structural Adjustment Programmes" (SAP) in some, they focus on the streamlining of government's role in the economy and the establishment of a free market economy in a more meaningful sense of the term. Their implementation is ushering in an era of unprecedented deregulation, privatization and competition, all of which are encouraging and healthy signs for economic growth.

However their policy implications pose a classic dilemma. To have economic progress, structural reforms are inevitable but avoiding the harsh consequences arising from them, calls for less or none at all. At both public and private sector levels, the initiated reforms though well-intentioned, have not been without costs. A typical example is the social costs in terms of retrenched jobs as employers carry out the rationalization of their organizational strategies. The economic implication manifests in the decline in earnings for employees due to high-frequency of factory shut-down and the rising cost of food and manufactured goods, both local and imported<sup>1</sup>. The Nigerian economy presents a unique example of a developing economy in the throes of structural reforms aimed at averting its continuing economic decline. It is also one which has lately recognised the pivotal position of its neglected small business sector in the restructuring process. Paradoxically, the human casualties of the rationalization programs have aggravated the unemployment situation, propelling the promotion of a fledging small enterprise sector which is expected to exert a soothing effect on it.

Conventionally, the emerging scenario creates the right climate in which entrepreneurial aspirations are unleashed<sup>2</sup>. This paper seeks to investigate how far the Nigerian case accords with this received wisdom as part of a broader inquiry into the motivations of small business start-ups in general, even though the available support-systems have not kept pace with the revolution of rising expectations. In other words, why do people venture into small business in Nigeria, even though the obstacles and risks are greater

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1. Part of this is the consequence of exchange rate realignment as well as the increasing difficulty in borrowing from international financing sources against the backdrop of mounting arrears in debt servicing.

2. For example see B. Gilad and P. Levine. "A Behavioral Model of Entrepreneurial Supply", *Journal of Small Business Management*. Vol. 24, No. 4, October 1986, pp. 45-53.

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than for other entrepreneurs while the chances for success are lower? What considerations determine their choice of business activity? Additionally, the paper addresses the related issue of the constraints to entrepreneurial endeavors in Nigeria.

## 2. Research Methodology

A structured questionnaire incorporating a large set of factors in the literature on the motivations of business founders, their choice of business lines and the constraints they meet was personally administered on a sample of small business firms. The sample consisted of firms in manufacturing, wholesale and retail trade as well as in the service industry. The instructions required respondents to rate the motivational and influential factors in their decision to pursue a particular line of business activity according to their importance on a 5-point horizontal numeric scale. Low-points on the scale denoted "extremely unimportant" factors and high-points, "extremely important" factors. "Important" factors were denoted by the mid-points.

The sample population was non-random but represented firms with characteristics believed to be consistent with the hypothesized national character of small business firms drawn from four cities in the southern States of Nigeria. Of the 511 out of 1000 respondents or 51 percent, whose completed questionnaires were usable, 70 percent were sole-proprietory in ownership. 19 percent were owned and managed as private limited liabilities and 11 percent as partnerships. In terms of duration of operation, 39 percent were under 5 years at the time of the survey<sup>3</sup>. 53 percent were between 5 and 15 years and 6 percent, between 15 and 25 years. Only 2 percent were over 25 years of age. In the absence of a databank from which to obtain a reliable list of qualified firms, the classification adopted by the Central Bank of Nigeria (CBN) was employed to delineate the relevant size of firms investigated<sup>4</sup>. Majority of the sample (80 percent) fell within the range of annual sales turnover of not more than N50,000.

## 3. Results

### 3.1 Motivations.

The motives for starting a business are many and vary from one business founder to

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3. The survey which was conducted from January to March 1987 was restricted to firms established by the end of 1986 and based in Lagos, Enugu, Aba and Benin City.

4. The Central Bank of Nigeria (CBN) defines small-scale enterprises as firms with annual sales turnover of not more than N500,000.

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another. Broadly speaking, they may be responses to a variety of environmental or behavioral stimuli<sup>5</sup>. To understand the forces at work in Nigeria, the respondents were posed this question:

“Why did you go into business?”

Responses to the above question intended to obtain clues on which of the seven suggested factors is most influential are provided in Table 1.

The respondent's ranking of the factors on a 5-point scale shows expressed need for independence through self-employment as the most extremely important (mean 3.83). The opportunity afforded the business owner to practicalize a cherished or “pet” idea comes next with a mean of 3.82. The third ranked extremely important motivation is the promise of higher financial returns from small business activity (mean 3.77). Building up a business for the future (mean 3.77) is ranked as the fourth extremely important motivational factor.

The rest of the seven listed factors — supplementing present income (mean 2.37), immediate need for job because of loss of a previous one (mean 2.06) and immediate need for job because of fear of imminent loss of a present one (mean 1.97) are rated as extremely unimportant. However, one of the respondents cited unavailability of educational opportunities as an important “push” factor for entering business. At a glance, this factor appears insignificant statistically. But its implication must be assessed against the backdrop of a social setting in which paid-employment is highly venerated. Until lately, there had been a deep-seated belief that running a business was inferior to paid-employment or synonymous with “dropping out of school”.

“Why did you decide on this particular line of business?” was another question asked to understand the reasons behind the choice of business lines by the respondents. Table 2 presents responses to this question. The personal preference of the business founder dominates the decision to prefer a particular line of business to another (mean 3.89). This singular reason is however influenced by a wide range of variables such as the availability of personal savings, willingness of the entrepreneur to accept challenges and a desire to pursue innovative ideas. In addition, the choice is to a large degree influenced by the previous job experience and/or training of the business owner/manager

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5. See B. Gilad and P. Levine, *Op. cit.* Also see D.C. McClelland, *The Achieving Society*. Collier-Mcmillan Free Press, 1961, pp. 205-390. K.B. Mayer and S. Goldstein, *The First Two Years: Problems of Small Firm Growth and Survival*, Washington D.C., Small Business Administration, 1961.

**Table 1**  
**MOTIVATIONAL FACTORS FOR ENTRY INTO BUSINESS**  
**(AVERAGE (MEAN) VALUES)**

Principal Motivation	Mean (N = 511)	Std Deviation	Rank
To be independent (self-employment).	3.83	0.82	1
To practicalize a "pet" or cherished idea.	3.82	0.81	2
To make "real" money.	3.81	0.68	3
To build up business for the future.	3.77	0.69	4
To supplement present income.	2.37	0.11	5
Immediate need for job because of loss of previous job.	2.06	0.12	6
Immediate need for job because of fear of imminent loss of present job.	1.97	0.08	7

Note: Ranking based on Mean values on a 5-point Horizontal Numeric Scale. Low points-"extremely unimportant"; mid-points - "important" and high points-"extremely important".

(mean 3.81). The availability of greater market opportunities or perceived market gaps (mean 2.79) constitutes an important and third-ranked factor.

Of least importance are other factors such as the continuation of family line of business (mean 2.08) and the financial limitations imposed on the choice of alternative business activities (mean 2.07).

### 3.2. Constraints

#### 3.2.1. Capital

Evidence on the acuteness of the finance or capital problem, indeed its pre-eminence over others in the small firm sector is rife in the literature<sup>6</sup>. The result of this study confirms it with 84 percent of its respondents citing it as the most critical in the running

6. M. Harper, *Small Business in the Third World*. John Wiley and Sons, Chichester, 1984, pp. 45-64. Also see K.J. Ramakrishna. *Finance for Small-Scale Industry in India*. Asia Publishing House, London, 1982, p. 1.

**Table 2**  
INFLUENTIAL REASONS FOR CHOICE OF BUSINESS (AVERAGE (MEAN) VALUES)

Principal Reason	Mean (N = 511)	Std Deviation	Rank
Personal preference	3.89	0.71	1
Previous job experience/ training	3.81	0.80	2
Availability of greater market opportunities	2.79	0.24	3
Continuation of family line of business	2.08	0.15	4
Financial limitations on alternative choice of business	2.07	0.04	5

Note: Ranking based on mean values on a 5-point Horizontal Numeric Scale. Low points-"extremely unimportant"; mid-points - "important" and high points-"extremely important".

of their businesses. Harper holds the view that most of the small business firms' problems in the area of production or materials, quality or marketing or even general management have a financial coloration. Undoubtedly, this appears to be substantiated by the knowledge that capital due to its fluid nature, lends itself to wide applications and usually do substitute for most of the other resources of the small firm.

The capital problem which mirrors the difficulty of raising it from external sources by small firms, manifests itself at varying stages of their operations. Hutchinson among others found the problem to be most critical at the inception and rapid-growth stages of these firms<sup>7</sup>. The results of this study accord with these earlier findings. Slightly more than half of the respondents (51 percent) view raising capital at the initial or early stage of their firms as the most difficult while 27 percent experienced this difficulty in the rapid-growth stage. The decline stage or the period when business conditions appeared to be unfavourable after one of growth is considered the most difficult by 13 percent of the sample. Only 9 percent of them encountered difficulty in borrowing from external sources in the maturity stage or when growth in their firms' sales stabilized.

7. L. Fertuck. "Survey of Small Business Lending Practices". Journal of Small Business Management, October 1982, pp. 34-35.



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### 3.2.2. Nature of the Capital Constraint

Numerous studies have shown working capital to dominate over the fixed or long-term capital needs of small firms<sup>8</sup>. The conventional evidence of the primacy of working capital is not lacking in Nigeria. 71 percent of the respondents rate it as their major limitation. As to what they perceive to be responsible for it, 37 percent of this group cite the behavior or attitude of commercial banks to small business lending. Next, the difficulty in obtaining credits from other sources is considered by 26 percent to be responsible. Pressure to extend credit to customers, shortage of internally-generated funds and poor collection of trade credits are held responsible for the working capital constraint by 17 percent, 15 percent and 5 percent respectively. For a sector with a large customer-clientele permeating the lowest social echelon and with equally low income levels aside from the usual common social links between customers and business owners, the pressure to extend credit is often irresistible and poor debt collection almost inevitable.

Of the remaining 29 percent who felt their capital constraint has to do with fixed capital, shortage of internally-generated funds comes top on the list. 36 percent of them cite it as the prime cause. The low level of internally-generated funds within this group is symptomatic of the low level of financial management as well as the high incidence of low capitalization in the sector. In the second place is difficulty in raising commercial banks' credits (27 percent). But difficulty in raising credits from other sources is considered by 24 percent of them to be responsible for this type of problem. However 13 percent of them attribute it to the limitations imposed on their firms' access to external sources of long-term credits by their ownership structure which is mainly sole-proprietory. Their responses with respect to the two types of capital constraints are presented in Table 3.

### 3.2.3. Problem of Commercial Bank Credits

It is widely acclaimed that commercial banks are the most dominant source of institutional credits for small business firms<sup>9</sup>. Nevertheless, obtaining credits from this source

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8. National Federation of Independent Business (NFIB). *Small Business Lending and Private Secondary Markets: Summary of a Round-table*. Research and Education Foundation, Washington D.C., 1984, p.1. Also see M. Bruch and U. Hiemenz. *Small and Medium-Scale Industries in the ASEAN Countries: Agents or Victims of Economic Development?* Westview Press, Boulder, 1984, p. 97.

9. National Federation of Independent Business (NFIB). *Credit, Bank and Small Business: 1980-84*. NFIB Research and Educational Foundation, Washington D.C., 1980, p. 3.

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**Table 3**  
TYPE OF CAPITAL CONSTRAINTS: PERCEIVED MAJOR CAUSES (PERCENTAGES)

Major Cause	Working Capital	Fixed Capital
Difficulty in raising commercial bank credits	37.0	27.0
Difficulty in obtaining credits from other sources	26.0	24.0
Pressure to extend credits to customers	17.0	N/A
Shortage of internally-generated funds	15.0	36.0
Poor collection of trade credits	5.0	N/A
Limitations imposed in firm by its ownership form	N/A	13.0
Total	100.0	100.0

Note: N/A Not applicable to the category.

is not usually a “free lunch”. Indeed, indications are that small business borrowers are often confronted with stiff conditions and obstacles. In order to probe into the nature of this difficulty in securing institutional credits, particularly commercial bank credits, their views were sought.

Among the respondents who considered working capital more critical, 61 percent perceive the lack or inadequacy of the types of collateral security demanded by banks to be responsible for their inability to secure bank credits. 14 percent of them blame it on administrative delays in processing their loan applications while 12 percent attribute it to unfavorable government policies — a powerful influence on banks' lending decisions<sup>10</sup>. High interest charges are viewed by 11 percent to be responsible for this difficulty. Admittedly, lack of confidence in their management competence by lenders is thought to be the major cause by a trifling 2 percent of this group.

For those who held difficulty in obtaining long-term credits from commercial banks responsible for the fixed capital constraint, lack or inadequacy of the required collateral

10. Bank lending policies are administratively guided through periodic “selective credit controls” by the Central Bank of Nigeria (CBN).

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als remain in the fore-front. 35 percent of them blame it for this difficulty. Unfavorable government policies follow in the second position with 25 percent of the group believing it to be the main cause of the problem. High interest charges and lack of genuine interest to lend long on the part of commercial banks are cited by 18 percent and 17 percent respectively. As in the previous case, only 5 percent admitted that the issue lies with lenders' lack of confidence in their management competence. The perceived causes of their difficulty in securing commercial bank credits, both working and fixed capital, are presented in Table 4.

#### 3.2.4. Other Constraints

Capital shortage is not the only problem afflicting small firms in Nigeria. The findings in this study reveal others which though secondary to the finance dilemma, also inhibit the small firms' operations. Of the 16 percent of sample population who share a contrary opinion about the primacy of the finance problem, 64 percent consider unfavorable economic conditions as the major constraint. Next, government regulations and policies are held by 12 percent to constrain their firms' operations. Marketing, recruiting the right people and technology are believed by 10 percent, 8 percent and 4 percent respectively to be their major obstacles. General management comes last with only 2 percent of the respondents perceiving it as the major constraining factor. Table 5 illustrates the relative positions of these other perceived constraints.

#### 4. Conclusion

This study's findings suggest that contrary to what might be expected in the prevailing economic circumstances in Nigeria, small business founders are neither strongly persuaded into business by the worsening unemployment situation nor by its imminent threat. Rather their entrepreneurial aspirations are fired foremostly by their desire to be independent, to translate some cherished ideas into physical goods and/or services as well as by the lure of high financial returns. To all intents and purposes, the high ranking for building up business for the future as one of the principal motivations, may demonstrate a submerged fear about future job prospects among other considerations. Given the inadequate support-systems for the sector, opportunities to start a business are bounded by the limits of the founder's resources, especially financial resources. In that case, the unemployed may be potentially but in reality, not a business owner.

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**Table 4**  
DIFFICULTY IN SECURING COMMERCIAL BANK CREDITS: CAUSES  
(Percentages)

Major Cause	Working Capital	Fixed Capital
Lack of inadequacy of desired collateral security	61.0	35.0
Administrative delays in processing loan applications	14.0	N/A
Unfavorable government policies on lending	12.0	25.0
High interest charges	11.0	18.0
Lack of genuine interest to lend long	N/A	17.0
Lack of confidence in firm's management competence	2.0	5.0
Total	100.0	100.0

Note: N/A Not applicable to the category.

**Table 5**  
ALTERNATIVE CONSTRAINTS FACING SMALL FIRMS

Constraint	Percentage
Unfavorable economic conditions	64.0
Government regulations and policies	12.0
Marketing	10.0
Recruiting the right people	8.0
Technology	4.0
General management	2.0
Total	100.0

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The capital constraint is pervasively the most disturbing of all constraints facing small firm owners, especially at the early and rapid-growth stages. In their views, the weight of the problem leans heavier on working capital and to a considerable extent can be traced to the attitude or behavior of institutional lenders, particularly commercial banks. Aside from the capital constraint, others are not totally inconsequential in their impact on small firms in Nigeria. At least, unfavorable economic conditions and government policies befog their operational horizons. Therefore a major challenge to economic planners and policy-makers in a developing economy lies in devising policies which create a suitable environment for small firm development. Their thrust should aim at an environment which not only equips them to perform better but also provides decipherable signals on what goods and services should be produced as well as the resources to the employed in the process. This challenge demands both imagination and knowledge.

### **Abstract**

*This paper investigates how far Nigeria's structural adjustment programs have contributed to the growth of more small businesses as part of a broader inquiry into the motivations of small business founders in Nigeria. It further addresses the related issue of the constraints to small business operations in the country. Evidence produced by the study does not show loss of jobs or strictly speaking, unemployment — one of the consequences of the structural reforms, to be a strong motivational factor. Rather, independence, innovation, financial returns and precautionary motives dominate the reasons for starting a small business. However there is a possibility that the insignificance of the unemployment factor may be related to the constraints to small business ownership identified in this study. Most important among them is capital constraint, both working and fixed capital. Others such as unfavorable economic conditions and government policies, etc are not inconsequential though, cause a lesser concern.*

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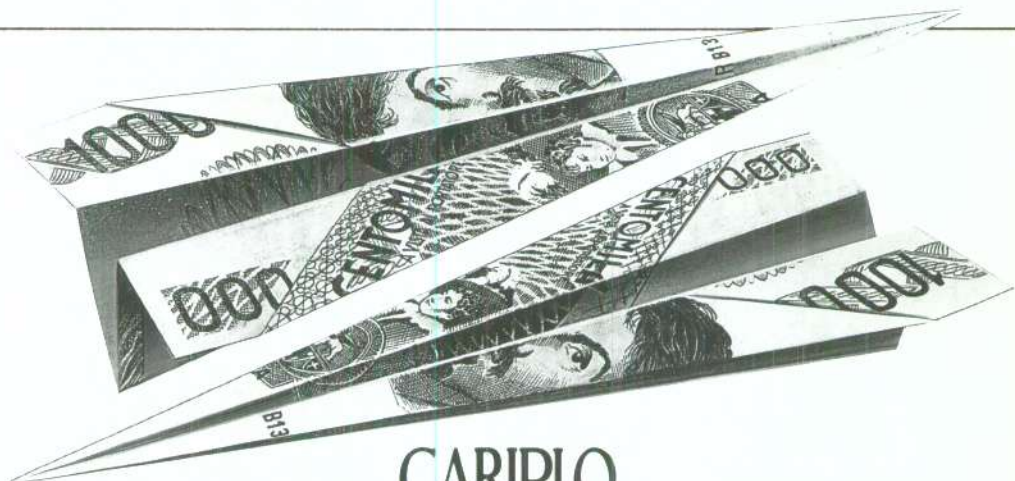
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